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CIVIL AERONAUTICS BOARD PRACTICES AND PROCEDURES

REPORT

OF THE

SUBCOMMITTEE ON ADMINISTRATIVE PRACTICE AND PROCEDURE

OF THE

COMMITTEE ON THE JUDICIARY

OF THE

UNITED STATES SENATE

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LETTER OF TRANSMITTAL

U.S. SENATE,
February 1975.

Hon. JAMES O. EASTLAND,
Chairman, Committee on the Judiciary,
Washington, D.C.

DEAR MR. CHAIRMAN: I am transmitting a report entitled: Civil Aeronautics Board Practices and Procedures. This report is the product of the Administrative Practice and Procedure Subcommittee's detailed investigation of the Civil Aeronautics Board's regulation of the airline industry. Based upon that investigation and the report's analysis, the subcommittee has recommended extensive administrative and legislative change.

Despite longstanding and widespread complaints about the performance of Federal regulatory agencies and many demands over the years for their reform, basic changes have proved difficult to achieve. There are several important reasons.

First, there is no single, easy answer to the host of different problems raised by different kinds of agencies administering different types of regulation. Blind adherence to simplistic political philosophies only hinder rather than help the reform effort. Responsible fair and effective Government in modern America does not necessarily mean either less Government in the image of Herbert Hoover nor more Government in the image of Franklin Roosevelt. Rather, regulatory problems must be approached without philosophical or political preconceptions.

Thus, while I personally believe that regulation is highly appropriate in many areas—safety, health, drugs, the environment—I have become convinced from this subcommittee's inquiry that in the case of airlines, less economic regulation and increased reliance upon market forces will mean lower fares and increased protection for the consumer.

Second, the job of determining what sort of reform is needed in a specific agency is complex, time consuming, and technical. Congress cannot be certain that the critics of regulation, or supporters among the regulated industries, are right. Nor is the remedy apparent until all sides have been heard and their arguments examined.

The investigation of airline regulation required detailed exploration of such issues, for example, as whether climate, traffic density, airport delays, or simply increased competition is primarily responsible for low fares in California (where the CAB does not regulate). Only after digging out the facts and hearing the experts in this and other complicated areas was it possible to be reasonably certain that Board regulation itself lies at the heart of the high fare problem.

Third, regulatory reform may have been hampered by a lawyer-like but naive tendency to rely too heavily upon procedural solutions to regulatory problems. While our investigation shows that improved procedures are vitally needed, procedural reform alone is not enough to do the job. Rather, the CAB's problems arise in large part from a misguided effort to regulate prices in an industry where price competition might otherwise flourish. A fundamental redirection of the regulatory effort—not simply procedural improvement—is required.

Finally, it has proved difficult in the past to sustain public interest in regulatory reform over the time needed to investigate an agency, to formulate proposed reforms, and to enact them into law. The Congress tends to be guided by the public's sense of priorities, which shift from time to time. At present, however, the manifest lack of public trust in Government suggests that the public needs—indeed demands—changes that will make Government more responsive to the problems of this third century of American democracy.

I hope that this Report will be followed by congressional action; and that action in this area will be followed by further investigation, report, and legislation focusing upon other regulatory agencies. In such a methodical, step-by-

step way, captive agencies can be freed from their shackles—forged, sometimes by the industries they regulate, but as often by outdated philosophies, obsolete statutes, archaic procedures, and inadequate staffs or methods of operation.

By improving the efficiency and the fairness with which Government operates, Congress can help to restore the confidence of the people in their Government. The results will justify the effort, and the outcome will be a fitting reward as we try to make America work again.

Sincerely,

EDWARD M. KENNEDY,
Chairman, Subcommittee on Administrative Practice and Procedure.

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AIRLINE REGULATION BY THE CIVIL AERONAUTICS BOARD

SUMMARY OF REPORT

This report presents the recommendations, conclusions, and analyses of the members of the Subcommittee on Administrative Practice and Procedure arising from the subcommittee's comprehensive 1975 investigation of the Civil Aeronautics Board's practices and procedures. In that inquiry the subcommittee asked two basic questions: First, whether the Board's practices and procedures are fair. Are the Board's decisions made openly after adequate opportunity for affected persons with differing views to present evidence and arguments? Are they based upon evidence in the public record? Second, whether the Board's practices and procedures are effective. To what extent have they led to "adequate, economical and efficient service by air carriers at reasonable charges?" Have they both encouraged the growth of a healthy aviation industry capable of satisfying the Nation's need for air service and made that service available to the traveling public "at the lowest cost consistent with the furnishing of such service?"

The subcommittee has reached five general conclusions concerning the CAB's practices and procedures during the past few years:

1. The Board's practices, while effective in promoting industry growth, technological improvement, and reasonable industry profits, have not been effective in maintaining low prices. It is economically and technologically possible to provide present air service at significantly lower prices, bringing air travel within the reach of the average American citizen.

2. Several of the procedures that the Board follows in setting major Board policies—in particular, route and enforcement policies—have lacked the openness, intelligibility, and impartiality required by elementary notions of procedural fairness.

3. The CAB should shift the focus of its attention from the problem of promoting the growth of the aviation industry—a goal that is consistent with a large number of aircraft, frequently scheduled service, and comparatively empty airplanes—to the problem of making that service economically available to more of the American public—a goal that is consistent with fuller planes, reasonably frequent service, and significantly lower fares. The Board's present ratemaking procedures are ill suited to this goal. Instead, it will be necessary for the Board to encourage price competition, to adopt a more liberal entry policy, and to use more sparingly its power to grant immunity from the antitrust laws.

4. To secure the adoption of these policies, Congress should enact legislation designed to limit the CAB's powers to control prices, restrict entry, and confer antitrust immunity.

5. The shift towards a policy that relies heavily upon competition must take place gradually, allowing a reasonable transition period for the industry to adjust.

The following few pages will summarize the report's argument supporting these general conclusions and the more specific recommendations it contains. The facts and figures contained in this report are based upon the state of the industry, the economy, and regulation as the subcommittee found them in the spring of 1975, and, unless otherwise noted, do not reflect those changes in regulation that may have taken place since, or in response to, criticisms voiced at the hearings.

I. BACKGROUND

A combination of Federal subsidy and Federal regulation is largely responsible for the present structure and performance of the domestic scheduled airline industry. Before 1934 the Post Office administered a system of subsidy that carried with it substantial power to determine which airlines would fly which routes. Dissatisfaction with this system led Congress between 1934 and 1938 to try alternatives, ininclding the vesting of significant regulatory power in the Interstate Commerce Commission. 1938 saw the creation of what is essentially the present system of airline regulation by the Civil Aeronautics Board, with the twin objectives of promoting the growth of aviation while maintaining fares sufficiently low to allow the public access to air travel.

The Board is equipped with three basic powers: 1) the entry power: the power to grant or to deny "certificates of public convenience and necessity" which an airline must have to fly interstate; 2) the rate power: the authority to suspend or to set air fares; 3) the antitrust power: the power to approve (or disapprove) agreements among airlines, with approval conferring immunity from the antitrust laws. In addition, the Board has certain subsidiary powers, including the power to authorize mergers, the power to administer a subsidy, the power to regulate certain peripheral matters of airline service (baggage liability, tariff quotations, discrimination), and the power to enforce its own regulations.

The domestic industry has grown phenomenally since 1938: revenue passenger miles have increased from 476 million to 114 billion; investment has grown from $30 million to $7 billion. Scheduled carriers now serve 430 cities. Still, the basic structure of the industry has changed surprisingly little.

In 1938 the industry consisted of sixteen trunk carriers; today those sixteen have been reduced through merger to ten, which account for more than 90 percent of all scheduled airline service. In addition, local service carriers provide scheduled regional service; supplemental carriers provide charter service; and small unregulated commuter carriers provide local service. Finally, several scheduled carriers provide service wholly within California and Texas, which is not regulated by the CAB since it does not cross state lines.

II. THE BASIC ARGUMENT: SHOULD THERE BE MORE COMPETITION?

A. THE THEORY

The Board's critics claim that its reliance upon classical route-award and ratemaking procedures has brought about fares that are far too high. The airline industry is potentially highly competitive, but the Board's system of regulation discourages the airlines from competing in price and virtually forecloses new firms from entering the industry. The result is high fares and security for existing firms. But the result does not mean high profits. Instead the airlines—prevented from competing in price—simply channel their competitive energies toward costlier service: more flights, more planes, more frills. Thus, the skies are filled with gourmet meals and Polynesian pubs; scheduled service is frequent. Yet planes fly across the continent more than half empty. And fares are "sky high."

The remedy is for the Board to allow both new and existing firms greater freedom to lower fares and greater freedom to obtain new routes. This freedom should lead the airlines to offer service in fuller planes at substantially lower prices, a form of service that most consumers desire.

Although a more competitive system with lower fares on fuller planes can be profitable, the process of introducing new firms or price competition may create added financial risk for some existing airlines in the short run. Yet short-term financial security for all individual carriers is currently being purchased at a fearsome price in excess fares—an excess used to support the purchase of more planes than are needed. This excess has been estimated at between $1 billlion to $3.5 billion annually. It should be possible to introduce increased competition gradually without seriously jeopardizing the health of the industry thereby bringing air travel into the lives of millions of working people who now cannot afford it.

B. EMPIRICAL EVIDENCE

The strongest empirical confirmation of the critics' argument arises from comparing fares and service in California and Texas—where new firms and price competition have been allowed—with flights elsewhere in the Nation where competition is more restricted by the CAB. A traveler flying 456 miles from San Francisco to San Diego pays $27. on strictly comparable routes elsewhere in the country the traveler must pay at least 60 percent more. As of February 1, 1976, it costs $47 to fly 399 miles between Boston and Washington, D.C. A comparison of virtually any intrastate route (which the CAB does not regulate) with virtually any comparable interstate route (which the CAB does regulate) reveals similar fare differences.

Several major airlines argued that it was not CAB regulation but certain special circumstances that brought about such low fares within California and Texas. These included better weather, denser traffic, less congestion, the absence of interlining costs, the ability to operate turnaround service, and less need to support other routes in the system. The subcommittee examined each of these other factors

in detail and concluded that taken together, these factors account for less than half of the fare differences. Most of the difference arises from the fact that the intrastate carriers carry more passengers in their planes. The subcommittee also concluded that greater freedom to compete is probably responsible for these fuller planes and lower fares. New airlines willing and able to provide the public with fuller-plane, lower-fare service in California and Texas have been allowed to enter those markets, and the low-fare service they provide has led to greatly increased demand for air travel with a resulting increase in scheduled flights.

The California experience also suggests that a more competitive environment does increase business risks for individual carriers. But this added risk for individual firms does not seem to have seriously inconvenienced the public, for throughout this period continuity of low-fare service was maintained.

Further empirical evidence is contained in cost data submitted by Lockheed and Boeing, which show that it is economically and technically possible to provide California-type fuller-plane, lower-fare service throughout the United States. With an all-coach seating configuration, for example, cross-country service could be provided in a B–747 flying on average from 50 percent to 70 percent full at fares that range from $75 to $95. The current (as of February 1, 1976) cross-country CAB-regulated fare is $175.

Similarly, "value of time" studies suggest that all except the highest paid executives would prefer lower fares even if they were accompanied by a significant reduction in the number of flights flown, which they would probably not be. Finally, studies of air service in Canada, commuter service, and Military Air Transport Service suggest that where competition has flourished, fares tend to be low; where there is strict price regulation, they are high.

C. COUNTER ARGUMENTS

The major arguments against allowing freer entry and greater price competition rest upon the fear of: 1) predatory pricing; 2) destructive competition; 3) monopolization; 4) reduced service to small communties; 5) destruction of the existing air service network; 6) reduced safety standards; and 7) greater financing difficulties. The subcommittee examined each of these claims.

In the subcommittee's view there is no substantial historical, empirical, or logical reason for believing that increased reliance upon competition would lead to predatory pricing, destructive competition, or risk of monopolization.

The small community and "network" argument have two separate forms. First, it is often claimed that fares on popular routes must be high to cover the cost of less popular service. Investigation of this claim suggests, however, that no significant amount of such "cross subsidy" takes place. The subcommittee has carefully examined empirical studies submitted by United Air Lines and the Air Transport Association. It concludes that a more competitive system, of the type recommended by this report, might lead the major trunk carriers to seek to discontinue service over routes that, at the very most, account for one-half of 1 percent of revenue passenger-miles now flown. Service

over these routes even then would not terminate but, in all probability, would be supplied by commuter carriers. Even if contrary to the subcommittee's expectations, direct subsidy were needed, it could be supplied at a cost of several million dollars per year—a small price to pay for annual savings that could amount to more than a billion dollars.

Second, it is argued that increased competition will lead to fares that prevent the airlines from covering their overhead, forcing them to replace fewer planes and eventually to shrink their systems. Investigation of this claim suggests that though fares should fall as a result of fuller plane service and subsequent cost reduction, they will not fail to cover costs, for both new competitors and old ones will realize (as in all competitive industries) that failure to cover overhead means eventual bankruptcy. Of course, increased competition may lead to changes in the individual route maps of one or more existing carriers. But, it should not significantly alter the extent to which towns are served by the system *taken as a whole*. In fact, lower fares to and from major hubs should increase demand for air travel to and from smaller communities as well, with the probable result that service to those communities will increase, not diminish. In any event, the subcommittee projects that the gradual introduction of increased price competition and more liberalized entry will not diminish service to smaller towns, nor will it injure the nationwide service network.

The subcommittee is convinced that increased competition would not affect carrier safety. Safety is the primary responsibility not of the CAB, but of the Federal Aviation Administration. The FAA would continue to apply its rigid safety standards. The safety records of both the scheduled carriers, subject to full fledged CAB rate and entry regulation, and the supplemental carriers, subject to less-stringent rate and entry regulation, are excellent. As no change in safety regulation is proposed, those records should remain excellent.

The subcommittee does not believe that increased competition will raise any serious difficulty for the financing of new aircraft. It will, however, increase business risks for individual firms when compared with a more sheltered environment protected by the CAB, which has never allowed a major airline to go bankrupt. The subcommittee has sought to minimize these risks by recommending a gradual transition to a more competitive environment. This transition should also allow adequate time for any unforeseen adverse consequences to appear and to be dealt with.

In sum, the subcommittee believes that a gradual transition to a significantly more competitive industry environment will bring substantial benefit to the American traveler without jeopardizing the financial health of the aviation industry.

III. PRESENT BOARD REGULATION

The subcommittee's recommendations for reform of airline regulation rest in large part upon its detailed examination of existing CAB practice. In each major area of CAB regulation, the subcommittee has found serious problems of unfairness and ineffectiveness. It has concluded that present CAB practice is fundamentally deficient.

A. ROUTE AND ENTRY POLICY

The Federal Aviation Act instructs the Board to issue a certificate of convenience and necessity allowing an airline to fly a particular route if "the applicant is fit willing and able . . . and such transportation is required by the public convenience and necessity." The statute requires the Board to set an application for public hearing and to "dispose of such application as speedily as possible." The legislative history of these provisions suggests that Congress intended the Board to implement a cautious, but moderately liberal, policy allowing new firms to enter the industry as the market for air travel expanded. The Act's sponsors, Senators Harry Truman and Pat McCarran, assured the Senate that the 1938 Act would not prevent new entry into the industry.

The route policies actually followed by the Board, however, have been quite different. First, entry into the industry has been effectively blocked. Between 1950 and 1974 the Board received 79 applications from firms, outside the domestic scheduled airline industry, wishing to offer domestic scheduled airline service. Not one was granted. With a few minor exceptions, since 1960 the Board has not even set such applications for hearing. Moreover, since 1969 the Board has imposed a "route moratorium," refusing to allow even firms inside the industry to acquire new routes, nor would it set such applications for hearing.

Second, the Board has awarded routes in a manner designed to keep the market shares of the major existing firms fairly stable. In 1938 the four major carriers—United, American, Eastern and TWA—accounted for 82.5 percent of all revenue passenger miles flown; in 1972, they accounted for about 60 percent. In 1938 United, the largest airline, accounted for 22.9 percent of the market; in 1972, after merging with Capital, it accounted for 22.0 percent. Moreover, the Board has not allowed any major carrier to go bankrupt, but, instead, has authorized mergers. The present 10 domestic trunk, carriers directly descend from the 16 in business in 1938; the nine existing local service carriers descend from 19 airlines allowed to provide local service directly after World War II. No new domestic trunkline has ever been authorized, and only one new local-service carrier has been authorized since 1950.

2. Procedural problems

a. General problems.—The three most serious general defects in the procedural system used for the awarding of routes are: *1) Delay.*—More than two-thirds of all major route applications on the CAB's docket at the beginning of 1975 had been pending for more than 2 years. More than one-quarter had been pending for more than 5 years—a particularly large number in light of the fact that applications pending for more than three years tend to be dismissed automatically as stale. While delay is a problem common to many government agencies, in the case of the CAB it has helped to maintain a highly restrictive route award policy.

2) The "motion for an expedited hearing."—The CAB enforces its substantive route policy primarily through its disposition of a procedural motion which any airline applying for a route must make. Simultaneous with or subsequent to filing for a route award, Board

procedure provides for an applicant to file a motion requesting an expedited hearing on that route application. Ostensibly, this is ismply a procedural motion. In reality, if the Board is willing to grant the route itself, it then grants a hearing. If it is unwilling to grant a route, it denies a hearing. Thus, the decision that is supposed to be made *after* a hearing—whether or not a route is to be awarded—is really made *prior* to the hearing. In effect, the hearing is held only if the decision to award the route has already been made. Applications denied "expedited" hearings languish on the CAB's docket for three years and are then dismissed as "stale."

This system effectively insulates the CAB's route decisions from criticism and review. Because a restrictive route policy takes the form of "refusals to grant expedited hearings," reviewing courts are less likely to interfere, for the CAB claims that it is simply exercising its discretionary power to organize its own docket. The losing applicant has an uphill battle to convince a court to overturn a decision that on its face seemed to say only that it must wait for an "ordinary" rather than an "expedited" hearing. Of course, an "ordinary" hearing is almost never ever held.

3) Lack of standards.—Studies prepared for the subcommittee confirm the conclusion reached by many Board critics: namely, that the Board lacks consistently applied standards in route cases. The decision to award new route authority has been governed by a host of standards, which aim at promoting efficient, integrated systems. Yet, these standards are not only varied and complex; they are inconsistently applied. More importantly, the decision as to which carrier is to be awarded a new route is, in the words of the Board's own staff, "random."

From 1969 through 1974 the Board implemented a "route moratorium", a policy consisting of a general refusal to grant or even to hear applications for new routes. In 1969 and 1970 Board Chairman Secor Browne and several other Board members became concerned about overcapacity in the industry, a problem frequently mentioned to Board members by industry representatives in private meetings. Chairman Browne then gave a series of speeches calling for route restraint. He let the staff know that the Board's policy was not to award new routes. As a result, the Board and the staff did not act on route applications; it simply did not provide hearings. In essence, the basic reason for the Board's failure to set route cases for hearing in the past few years is not lack of administrative resources but, rather, a policy decision by the Chairman, taken without hearings or formal consultation with other Board members, to slow down the granting of route awards.

In the subcommittee's view, this method of determining important route policy was highly improper and probably unlawful. For one thing, the CAB held no public hearing about whether or not it ought to adopt a more restrictive route policy. Yet, such a hearing was plainly called for. Moreover, the policy itself of refusing to grant hearings would seem to conflict with the Board's statutory obligation to set route applications for hearing and to dispose of them "as speedily as possible." Finally, the failure to articulate a clear policy together with the Board's enforcement of that policy through the procedural device of refusing expedited hearings, made it virtually impossible to obtain judicial review of the "route moratorium" policy.

Instead of using this highly informal procedure to effect a major change of Board policy, the Board should have published notice of its intent in the Federal Register and held a public hearing. The public would then have had an opportunity to argue the merits of the route moratorium, the Board would have been exposed to a variety of other positions about the best way to cure industry problems, and the affected parties might then have appealed an adverse decision to the courts.

4) Other improprieties.—In examining the procedures used to develop and enforce the route moratorium, the subcommittee discovered a number of disturbing examples of Board practice. First, a memorandum sent by an administrative law judge to Board Chairman Robert Timm stated, "the following route cases, which have been set for hearing by Board order, have not been noticed for a conference and hearing before an administrative law judge pursuant to informal instructions of the Chairman's office in connection with the unofficial route moratorium." The evidence demonstrated that the "informal instructions" were sent by the office of the previous Chairman, Secor Browne, without consultation with other Board members. The type of informal action that this memorandum suggests is highly improper.

Second, the frequency of informal private communication between Board members and representatives of industry is troublesome particularly when—as in the case of the route moratorium—the meetings are followed by Board speeches and actions that reflect the views of major airlines. In 1974, for example, Board members' calendars show 769 private meetings with industry representatives. Although there may have been no impropriety committed at any particular meeting, the subcommittee recommends that the Board reformulate its rules dealing with ex parte communications. Those rules should not forbid informal contact with the industry; such contact is often necessary and desirable. They should, however, require logging and disclosure of private communications so that, in cases where Board policy is at issue, the public will be able to monitor industry imputs and those with different views will have a greater opportunity to meet and to dispute industry arguments.

Third, throughout this period, all route memorandums prepared by the Board's Bureau of Operating rights contained three parts: a recommendation, a description of the effect on the industry's rate of return, and a discussion. While rate of return is one, among several, factors that the Board might take into account in a route case, highlighting it in this way suggests that is is the most important factor, which it ought not to be.

5) A basic difficulty.—The difficulty of developing consistent route award standards may have tempted the Board to develop and enforce route policy through procedural decisions—decisions which are more difficult for courts to reverse and the public to criticize. That fact, in turn, many have made the Board less sensitive to the need for holding hearings prior to major changes in substantive policy. In any event, the procedural complexity and unfairness constitute independent reasons supporting development of clear route award standards. In developing clearer standards, the Board might move in the direction of awarding routes to any "fit, willing, and able" applicant, or in an opposite, highly restrictive direction. The subcommittee believes that the least restrictive of these paths is the right one.

6) Conclusion.—In the subcommittee's view, the Board's route policies in general and its present route practices and procedures in particular have tended to thwart the provision of low-cost air transportation to the American public. Its restrictive entry policies have inhibited price competition that might otherwise have brought about lower fares and fuller planes; they have tended to stabilize the market shares of major firms. On the other hand, the Board has made serious and successful efforts to promote the expansion of the nation's air transport system and to produce a reasonably efficient route network; it has also avoided carrier bankruptcy.

Nonetheless, the subcommittee believes that the overriding goal of airline regulation now ought to be neither the protection of existing carriers, nor continuous industry promotion; instead it should be securing low-fare air transportation for the vast majority of the American public.

Moreover, procedural considerations suggest the need for fairly simple, coherent route award standards—standards that avoid giving the Board discretion to hand out such valuable commodities as routes free from effective court review. Such standards can be found in a system that moves towards awarding routes to those "fit, willing and able" to fly them.

B. RATE POLICY

1. Background.—The problems of the CAB's rate policies arise from the fact that the Board has tried to apply classical principles of price regulation to an industry a) that is structurally competitive, b) that is composed of several firms, each of which has different route structures, costs, and revenues, and c) that faces continuously changing cost and demand conditions. There are three basic ways in which the Board might try to carry out this task: First, it might hold lengthy public hearings concerning fares, and each change in fares, of each separate firm; second, it might set fares through informal negotiation with the industry; third, it might devise a complex system of formal rules designed to set fares almost automatically. The Board has dismissed the first of these methods as impractical; it practiced the second for some time, until the courts held it unlawful (it deprives all but the airlines involved of a meaningful opportunity to participate in the ratesetting process). More recently, the Board has tried the third approach—the development of a set of rules that should automatically determine what constitutes a "reasonable" fare, thus simplifying the hearing process.

The subcommittee concludes that the Board's present system of ratesetting (embodied in its recent *Domestic Passenger Fare Investigation* decisions), while administratively workable, tends to keep air fares unreasonably high. The subcommittee believes that the other two approaches—frequent individual hearings and informal negotiation—are neither practical nor desirable. Thus, it recommends that the Board revise more substantially its approach to ratemaking; it should no longer attempt to apply classical principles of ratemaking to this competitive industry operating in a volatile economic environment. Instead, the Board should rely more heavily upon competition—greater freedom to set rates together with greater freedom to enter the industry—in order to obtain low fares.

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2. The Present System.—Although the Board has the power to set carrier rates directly, because of the elaborate hearings required the Board has rarely exercised that power. For the most part its control of carrier rates takes the form of approving or disapproving requests for changes in present rates filed by carriers. In reviewing such requests in recent years the Board has applied standards set down in its recently completed *Domestic Passenger Fare Investigation* (DPFI). Those standards are designed to produce almost automatically "just and reasonable" fares.

Classical ratemaking—which works best when applied to a single firm, such as an electric utility—first determines the firm's "revenue requirement" by taking its costs and adding a reasonable return on investment. It then sets the firm's prices so that they generate this "revenue requirement." The Board applies these principles with important modifications: First, the Board looks, not at individual firms, but at industry, cost and revenue figures. Second, it adjusts the figures submitted to it in order to determine what industry costs and revenues *would have been* if the industry had met certain "load factor," seating and other Board standards. The Board sets a "revenue requirement," which equals the industry's "adjusted" costs (the costs it would have had had it met the Board's standards) plus a 12 percent return on investment. Third, the Board sets fares at a level sufficient to generate this "revenue requirement." This fare level consists of a fixed charge (now about $14) plus several cents per mile (more per mile for shorter flights). Fourth, the Board publishes every 3 months a compilation of industry cost and revenue figures with adjustments. Thus, it is a simple matter for any firm to determine exactly what fare level the industry is entitled to set. It can then file a new tariff embodying that fare level, and the Board should be reasonably certain to approve it.

a. The Effect on Price.—The subcommittee has determined that the present system, though it may be administratively desirable and an improvement over past practice, has failed to keep prices low and has probably contributed to the rapid increase in air fares (not commensurate with increases in costs).

Those features of this system that have tended to keep ordinary fares at unreasonably high levels include the following:

1) The "load-factor" standard is too low.—Studies based upon the value passengers place on their time, as well as experience in California, where passengers have chosen to fly in planes 60 to 70 percent full, show that most travelers—if given the choice—would prefer to fly in planes fuller than the Board's 55 percent and to pay correspondingly lower fares.

2) The "load-factor" standard represents an industry average.—The Board's standards push the industry towards flying planes 55 percent full on average but allow load factors to vary widely on particular routes. Planes on more competitive long-haul, transcontinental routes have tended to fly emptier than those on less competitive short, or medium hauls. Most travelers probably would prefer the opposite pattern of frequency of service.

3) By insisting that carriers charge equal fares for equal distances, the Board effectively prevents selective price cutting.—In industries with only a few firms, fear of immediate retaliation makes general price-cutting

rare; price floors are eroded only as firms each begin to make a few selective price cuts in limited areas. The CAB's rule of "equal fares for equal distances" tends to make a carrier thinking of cutting prices on some routes cut prices on all its routes and it thus discourages any price-cutting at all. The rule does not produce "cost-related" fares, for routes of equal distances often have very different costs. Instead, the rule, which is imposed for reasons of administrative convenience, leads to excess service on some routes, inadequate service on others, and varying degrees of route profitability, which in turn encourages the CAB to distort route structure in order to help low-profit carriers.

4) The Board's rules inhibit across-the-board price cuts.—The Board's rules would not allow a carrier to cut its prices across the board if, when the cut is met by its competitors, the entire group of rivals will not earn a 12 percent return. Thus, the ordinary workings of price competition, through which more efficient firms can capture customers from less efficient, are stopped. And a carrier believing that travelers would prefer fuller-plane, lower-fare service is effectively prevented from testing out its beliefs in the market place (for they might lead to one or more rivals at least temporarily losing money).

5) The Board's profitability standards and demand projections are highly inexact.—After hearing conflicting opinions about the "proper" profit level and how demand is likely to respond to changes in price, the subcommittee believes that the present CAB profit standard (12 percent return on total investment; between 17 percent and 22 percent return on equity) is high. But, it also believes that there is no scientific rate setting system that can produce precise answers to these highly uncertain questions.

6) Other features.—Although firms can obtain almost automatically fare increases when the Board's rules show that fares are too low, the Board's statutes make it difficult to force a rate reduction when it believes fares are too high. Moreover, the system, which works on an industry average, does not easily allow the Board to determine whether a low industry return which might justify a fare increase is temporary or permanent, regional or national, caused by one carrier's problems or general.

b. The Effect on Efficiency.—By preventing selective price cutting and inhibiting general price cuts, the Board's policies tend to tolerate inefficiency, for it is difficult for more efficient firms to take business from the less efficient. Indeed, there are wide variations in firm efficiency. The Board has made little effort to penalize inefficient carriers. It may be hindered from doing so by its own rate (and subsequent route) policies which make it difficult to tell the extent to which high costs reflect inefficiency or a higher cost route structure.

c. The Effect on Profits.—The Board's policies may have had little effect in raising the general level of industry profits. The actual level of industry profits in most years has been well below the Board's target. Some expert witnesses believed that greater freedom to cut prices would increase industry profits by bringing about lower fares (and greater demand) during economic downswings.

4. Conclusions.—While some of the difficulties mentioned might be overcome through a reordering of the Board's priorities away from its traditional concern with maintaining industry stability, there can be

no major improvement without the abandonment of a purely administered rate procedure and the substitution of greater reliance upon the forces of competition in both route and rate areas. Thus, the subcommittee recommends freedom for the carriers to lower their fares and, as a more liberal entry policy takes effect, to raise them as well. As one immediate part of this effort, the subcommittee recommends the adoption of considerably more liberal charter rules and a subsequent expansion of charter service.

Alternative methods designed to bring about lower-fare, fuller-plane service are likely to be inadequate or undesirable:

a. A Board effort to raise load factor standards is desirable but inadequate.

b. While the Board should encourage the provision of fares that embody discounts based upon cost differences; fares that discriminate in price are less satisfactory.

c. Efforts to bring about lower fares through CAB-approved scheduling restrictions have proved a failure. They have brought about inferior service without any reduction in price. Such efforts should be abandoned.

C. ANTITRUST IMMUNITY: CAPACITY RESTRICTING AGREEMENTS

Ordinarily, agreements and concerted action between firms are unlawful under the antitrust laws if they unreasonably restrain trade. Agreements among airlines concerning scheduling, service, equipment, and several other matters must have Board approval to take effect. That approval carries with it immunity from attack under the antitrust laws. The Board receives about 1,000 requests for such approval each year; and about 10 percent of those requests raise significant antitrust issues.

The subcommittee has investigated in detail two of the most important, controversial areas in which the Board has wielded its extraordinary power to immunize otherwise unlawful business conduct from the antitrust laws: minimum charter rates (which is the subject of a separate subcommittee staff report) and capacity restricting agreements. The subcommittee's conclusion about capacity restricting agreements are similar to those it reached in the case of agreements to establish minimum charter fares, namely, the Board has followed procedures that are improper, and has promoted a result that harms, far more than helps, the traveling public.

Experience with capacity restrictions is enlightening for restrictions constitute one possible response to the basic problem noted by the Board's critics: The fact that Board rules that inhibit price competition will simply lead the airlines to engage in service competition instead. The airlines realize that too much service and excessive scheduling also mean lower profits. And, like their critics, they realize that frequency and timing of service is one of the few competitive outlets under price and entry regulation. The dilemma, then, was how to reduce service and operating costs without losing passengers to a competitive airline on a particular route. The response was that, in 1970, when, due to overcapacity, airline profits fell dramatically, a number of major carriers agreed collectively to cut the amount of service on major routes. The advantage (from the airlines' point of

view) of collective rather than unilateral behavior was that service reductions on multiairline routes could be tailored so that no airline was put at a competitive disadvantage, that is, so market shares could be preserved. Between 1971 and January 1975, the Board continually approved these agreements—usually for short periods of time initially, followed by renewed approval.

In fact, agreements reducing capacity (i.e., limiting service) in four major transcontinental markets were in effect since October 1971.

They were in effect in 20 other markets since October 1973; and they were in effect in the New York-San Juan market off and on from June 1972 to March 1974. The Board viewed them first as emergency economic measures to raise carrier profits and later as fuel saving measures. It held no hearing on these measures until mid-1973, when it began a hearing that concluded in later 1974. An administrative law judge then concluded that the agreements were both harmful and unlawful.

1. The Agreements' Effects.—Limitations on capacity, it has been argued, can reduce carrier costs and thereby bring about lower fares. The subcommittee found, however, that capacity restricting agreements brought about significantly reduced service on major routes *without* any compensating fare reduction *nor* any slowdown in the rate of fare increases. More specifically:

a. In the agreement markets, planes are more crowded; load factors increased 10 percentage points or more.

b. Profits in the agreement markets increased substantially. Profits, for example, on Los Angeles-New York, New York-San Francisco, Los Angeles-Washington, and Chicago-San Francisco routes increased to between 17 and 24 percent.

c. Some cities were hurt due to travel decline. In the two months of February and March of 1974, for example, Las Vegas lost about $1 million in nongambling revenue because of inability of travelers to secure plane reservations.

d. A great many passengers were unable to secure the flights they wished. For example, in just one 3-week period in October 1973, in four transcontinental markets United alone placed 1,465 people on its waiting list.

e. Employees have been laid off. The Air Line Pilots Association estimated that United and TWA have laid off more than 1,000 employees as a result of the capacity reductions.

f. The effect on price is negligible. There have been no price cuts resulting from these agreements. In fact, between the end of 1973 and 1974 prices increased nearly 20 percent on capacity restricted routes as well as others. On such routes the public paid the same, or more, for less service.

2. The Agreements' Justifications.—The subcommittee does not believe that the justifications offered for the capacity restricting agreements outweigh the harm they cause. Contrary to the claims of their proponents:

a. The agreements are unlikely to eliminate waste or to lower fares.—To bring about lower fares, the agreements would have to fill airplanes to the point where industrywide profits exceeded 12 percent. It is extremely unlikely that they could do so for several reasons. First, the Board cannot limit service competition on most routes, for it cannot *force* carriers to enter into these agreements. Many smaller carriers,

relying upon better service to attract customers from larger rivals will not enter into them. Thus, on most routes service competition continues. Second, the agreeing carriers may transfer airplanes from restricted routes where they are not needed to unrestricted routes. Such transfers, which are nearly impossible to detect, will shift the problem of excess capacity and losses to different groups of routes and airlines. The agreeing carriers may enjoy improved profits but average industry profits would stay about the same. Third, airplanes that are grounded because they are no longer needed may stay in the firm's rate base with their cost still charged to the consumer.

b. The agreements were not needed to raise industry profits.—For one thing, it is unlikely, for the reason just stated, that the agreements could raise industry profits, even though they might help some individual carriers. For another thing, industry profits were not so low as to require special emergency action. Excess ordering of equipment plus the cyclical nature of demand drove return on industry investment down to 1.5 percent in 1970. Yet, this level was comparable to other cyclical lows, when no special action was taken. It seems more reasonable to ask airline shareholders to bear the burden of overly optimistic management investment decisions (through temporarily low profits) than to ask the consumer to do so (through agreements to reduce service). Further, the very fact that the Board promoted industry agreements not to compete lessened the incentive for individual carriers to cut back service unilaterally.

c. The agreements themselves have not saved any significant amount of fuel.—Rather, fuel savings took place simply because the Federal Energy Office restricted the total amount of fuel that air carriers were allowed. It might be argued that agreements helped the airlines to maintain a better balanced pattern of service, yet Delta airlines, which did not enter into capacity restricting agreements, was able on its own to preserve an equally desirable balance of service between small and large towns.

3. Procedural difficulties.—The major defect in the procedure followed by the Board consists of its failure to hold a full hearing prior to putting capacity restricting agreements into affect. The upshot of the Board's action is that passengers in restricted markets had to suffer inadequate service and high prices for 4 years on the basis of reasons that failed to convince an administrative law judge once that hearing was held. Indeed, the Board did not even begin to hold a hearing until after the agreements had been in effect for 2 years.

The failure to hold a prior full hearing is particularly serious for three reasons. First, the need to limit capacity was one of the subjects often mentioned by major carriers during their frequent private conversations with Board members in 1969 and 1970. Such a background—even if the private meetings were conducted with great propriety—demands the fullest most open hearings if public confidence in the agency is to be maintained.

Second, the agreements constituted a major departure from past Board policy. Past Board cases indicated that the Board would not approve agreements repugnant to basic antitrust policy without a clear showing that a serious transportation need or other public benefit required approval. These agreements had enormous practical impact; they were plainly repugnant to antitrust policy, and whether they could be shown to be necessary to secure an important public benefit was doubtful from the beginning.

Third, the Board exhibited confusion about how to apply antitrust standards in the airline industry. This underlined the need for a public explanation prior to approval of the agreements of how they met the Board's standards or why those standards should be changed.

In the subcommittee's view, very low profits for one, two, or even three years do not create an emergency that warrants approval of seriously anticompetitive agreements without a Board hearing.

4. Conclusions.

a. The Subcommittee believes that capacity restricting agreements do not represent a practical solution to industry problems of overcapacity.

b. The Board's failure to hold a full hearing prior to allowing the agreements to take effect was unsound administrative practice, effectively foreclosing the opportunity of many of the agreements' opponents to argue their position.

c. Experience with capacity restricting agreements and with agreements setting minimum charter rates strongly suggests that the Board is insufficiently sensititve to antitrust policy and the need to minimize departures from competitive standards. Contrary to its expressed policy it has, in practice, been willing to approve seriously anticompetitive agreements without insisting upon a showing that they are necessary to secure important transportation objectives.

D. ENFORCEMENT AND CONSUMER PROTECTION

The subcommittee has examined the way in which the Board exercises its powers to enforce its rules and to protect consumers. It concludes that the Board's first priority has been the protection and the development of regularly scheduled air service. Efforts to obtain lower fares or better service for consumers have played only a secondary role.

One measurement of enforcement priorities is an analysis of the Board's allocation of its field investigative time. Between January 1971 and October 1974 the Board spent about two-thirds of its field investigative time trying to determine whether low-cost flights violated CAB regulations (restricting ticket discounting, unauthorized air transport, and charter flights). During that same period the Board spent only 3 percent of its field investigative time looking into consumer complaints (concerning, for example, overcharging, bumping, mishandled luggage). The CAB's Office of Consumer Advocate is also without adequate resources or authority to effectively perform its mission of protecting and advocating the interests of the consuming public.

Though the Board suggests more recently it has changed direction, the evidence concerning Board activity prior to 1975 confirms the impression made by the "field investigative time" statistics.

1. Enforcement that inhibits charter flights.—After hearing conflicting claims about whether the Board in its enforcement activities specifically discriminated against supplemental airlines—which provide charter service—the subcommittee has reached several conclusions:

First, the Board has misdirected its enforcement efforts. Far too many resources have been used in ways that inhibit low-cost travel in general and charter flights in particular. Far too few enforcement resources have been used to help the consumer.

Second, the Board's charter rules are unreasonably strict and the procedures used to enforce them are unfair and absurd. More than 60 pages of documents must be filed with fees before each charter flight—and all must be refiled in the event of any minor change in plans. Up to the last minute the carrier may receive a Board telegram warning of a possible "unlawful" passenger on the flight as indeed there may be, since millions of travelers cannot understand why they should be forbidden to fly charter simply because they have not belonged to the fraternal group, club or ad hoc organization for 6 months prior to the flight. Thus, in the words on one witness, even "members of the clergy or congregations of churches" may sometimes falsely sign affidavits affirming 6-month prior membership "without the slightest feeling of guilt." Upon receipt of the telegram, the carrier may have to cancel the flight losing a great deal of money even if it does not know whether there are "unlawful" passengers in fact on board. The carrier may have to cancel the flight for it will fear that in a subsequent CAB penalty proceeding it will be shown that such a passenger existed.

Third, the Board allocates its enforcement resources primarily on the basis of complaints that it receives. Since competitors are far more likely to complain than travelers, this system automatically skews the system against the consumer.

2. An example of the improper use of informal procedure to exclude a new competitor: The case of Air Europe.—Air Europe obtained permission from Mexico and Luxembourg to fly between Tiajuana and Luxembourg beginning Sept. 1, 1974, at a fare about half the regular Los Angeles-Europe rate. Air Europe believed that, since the flights took place outside the United States, no further CAB approval was necessary. The Board's staff, however, took a contrary position based upon the argument that the flights would constitute domestic travel (questionable legal grounds) and that Mexico had forbid Air Europe to market flights to Mexicans within Mexico (a incorrect factual assumption). The press then began to quote the Board or its staff as stating that Air Europe was "a cancer," "a private operation," that "we will stop them one way or another," that the Government was considering "boarding a U.S. marshal on the flight in Tiajuana and forcing the aircraft down in U.S. territory." As a result of this publicity, travel agents refused to handle Air Europe tickets and Air Europe was unable to begin service. It lost an investment of over $400,000, and travelers lost low-fare service.

Had the CAB, before taking action, given Air Europe an opportunity to meet the claims against it, it would have argued that the important factual allegation was false and that the staff's legal case against it was invalid. Alternatively, if the Board's actions and allegations had not been discussed with the press, Air Europe might have remained in business until formal charges were brought and it was given an opportunity to answer the charges against it. Instead, the public was deprived of low-fare air travel that might have been lawful through a combination of secret Board action and public press statements. At no point were the factual and legal merits explored in an adversary hearing.

In the subcommittee's view, the Board's method of proceeding was highly improper. And, its refusal to correct the damaging publicity

for which it is responsible, in part through having acted on false information is inexplicable.

Unfortunately, the Board's failings in this case are not uncommon. The subcommittee has found far too often—the case of minimum charter air fares, many route cases, basic route policy, and now Air Europe—that the Board either makes no effort to devise an appropriate adversary proceeding, or holds hearings only after a basic decision has been made. Moreover, this instance, together with the Board's treatment of Laker Airways' transatlantic application, the documented complaints of the supplemental airlines, and the Board's manpower-use statistics, suggests that the Board has persistently, and always fairly concentrated its enforcement efforts upon stopping allegedly improper low-cost travel.

3. Failure to devote resources to consumer problems.—In recent years the Board spent about 3 percent of its field investigative resources on consumer problems, and it has devoted a fairly small proportion of its total resources to this area. Yet, such problems are serious.

Overcharging, for example, where travelers are sold more expensive tickets than they need to travel when and where they want is quite common. Consumer surveys indicate that a quarter or more of tickets for connecting service are being sold at prices higher than the minimum lawful tariff. It has been suggested, in fact, that about half of all air travelers pay too much for their flights.

The main cause of overcharging is the complexity of tariffs, but the airlines themselves contribute by making little effort to see that customers are sold the lowest priced ticket for their needs. To the contrary, it found that American Airlines instructs its personnel that "American's basic sales policy is to sell the highest priced product that the consumer is willing to buy to obtain the service he prefers." And, TWA instructs its salesman to encourage an immediate sale by telling customers that planes are nearly full, when they are not. Given this sort of policy and the complexity of tariffs, it is not surprising that many travelers fly at higher fares than those to which they are entitled.

To the subcommittee's knowledge the Board has not treated overcharging as a major problem, it has not examined the airlines' sales techniques, it has not read through their sales manuals; nor has it instructed the airlines to try to find the lowest fare that suits a traveler's requirements. In fact, when new discount fares took effect in January 1975 the Board did not require that passengers already holding tickets be told of possible savings; though when fares increase, the Board does require passengers already holding tickets to pay the premium.

Bumping is also common. Consumer organizations testified that more than 100,000 passengers are turned out of their confirmed seats each year because the airlines have overbooked the flight. Although some overbooking is unavoidable, Eastern Airlines has shown that harm to passengers can be minimized by giving prospective travelers the choice of a lower fare service that carries with it the risk of being bumped (and receiving a free trip on the next available flight). Other airlines, with Board approval, bump passengers indiscriminately: they are required only to offer compensation (in an amount equal to the fare)

to those delayed more than 2 hours domestically or 4 hours internationally.

Moreover, the Board's procedures for dealing with consumer problems work very slowly. A complaint against Allegheny for refusing to pay compensation to bumped passengers took the Board three years to process; it took 8 years for the Board to resolve complaints of unfairness in the operation of airlines' VIP lounges. Despite numerous complaints about airlines' rules that limit their liability for negligently lost luggage to $500, it took the Board more than a year and a half to decide to grant the petition of a consumer group (the Aviation Consumer Action Project) to open a rulemaking proceeding about them. And, more than a year passed without the CAB's taking action on a Consumer's Union petition that the Board review airline rules on transport of dogs, cats and other pets—rules that the Consumers' Union claimed led to the death of many animals.

Of course, not all problems can be solved at once, but the delay in this area constrasts starkly with the efficient enforcement mechanism that fires off telegrams at the slightest suspicion that a passenger who has not belonged to a travel club for 6 months has managed to get aboard a charter flight.

4. Failure to investigate fully the possible illegality of certain airlines' political campaign contributions.—On March 21, 1975, the subcommittee held a special hearing to consider evidence that a Board investigation of unlawful airline political campaign contributions had been improperly limited and later halted. The investigations were begun in the summer of 1973 after American Airlines revealed that it had given unlawful campaign contributions in the 1972 presidential campaign. The Board wished to ascertain whether airlines had violated its rules requiring the *reporting* of political contributions.

At the outset the Board's Bureau of Enforcement was instructed by the Chairman's office to limit strictly the questioning of airline officials. Suspicious answers to investigators' questions were not followed up.

In early November 1973 Acting Chairman O'Melia was head of the Bureau of Enforcement. He testified that at the end of the first week of November Mr. Heye, the then Chairman's administrative assistant brought him a note from Chairman Robert Timm, telling him to close the 34 investigations. Mr. O'Melia testified that he said he would not do so. Mr. Timm and Mr. Heye strongly denied, in their testimony, the existence of any such note or instruction.

On November 5, 1973, all 34 investigations were closed, the papers were collected, put into 34 files and locked in the Bureau's safe. They remained there until found and brought to the subcommittee in February 1975 by the then head of the Bureau of Enforcement. Examination of those files suggests that the investigations were seriously incomplete.

The subcommittee's March 21 hearing suggests the possibility of highly improper or unlawful behavior on the part of Board officials. In light of the possibility of perjury flowing from the directly conflicting statements by an Acting Chairman and a past Chairman of the Board, and the possibility of an unlawful obstruction of administrative proceedings, the subcommittee has referred the record of the hearing to the Department of Justice to see whether criminal prosecution is warranted.

Conclusions and Recommendations

The subcommittee's conclusions and recommendations are set out in detail at pp. 177–90. In summary form, the subcommittee has concluded the following:

1. Many of the Board's procedures fail to meet commonly accepted standards of fairness and openness. In some instances major policies have been determined without a prior opportunity for the public fully to present arguments and alternatives. In other instances, individuals have been hurt as a result of procedurally unsound Board action. This conclusion applies, in particular, to the Board's route award procedures, the route moratorium, the "motion for expedited hearing," intervention by the Chairman's office in route cases, the "minimum charter rate" experience, the capacity restricting agreements, charter rule enforcement, the Air Europe case, and the campaign contribution investigation.

2. Board regulation has not effectively brought about the low-fare service that is technically feasible and that consumers desire. Instead it has sought primarily to protect the regularly scheduled airline industry and to promote regularly scheduled air service.

3. Air service can be made available to the American public at significantly lower prices. Increased competition is likely to bring about the provision of such service. The major alternatives to increased reliance upon competition, namely, stricter ratemaking standards, discount fares, and capacity restricting agreements, are less likely to prove effective.

4. To some extent the Board's failings reflect the inherent difficulty of applying classical rate and entry regulation to a competitive, economically volatile industry. Classical ratemaking sets fares that equal costs (including a reasonable profit). Yet the Board's experience suggests it is extremely difficult, if not impossible, to develop a cost-based ratemaking system that uses fair procedures and keeps fares in such an industry low.

Classical entry regulation substitutes for impersonal market forces, which tolerate bankruptcies and allow the efficient, aggressive, or superior firms to survive, personal quasijudicial decisions by regulators, who inevitably feel responsible for the "health" of the firms they regulate, who tend to see "fair" decisions as those that treat with rough equality the various industry claimants before them, and who thus seek industry stability and improved service. Given the difficulty of fashioning a set of consistent standards for awarding routes that will meet these objectives, that will conform to statutory requirements, and that will help to keep fares low, it is not surprising that the Board has tended to avoid hearings, to rely on informal negotiation, and, when denying route applications, to substitute for substantive criteria, procedural ones, which are less open to outside criticism or review.

Finally, the classical regulatory response to defects in regulation is to create more regulation: The Board's response to the problem of excess capacity was to introduce capacity restricting agreements. Yet, to do so in this highly competitive, complex industry brought the consumer the worst of both worlds, high prices and poor service.

This is not to say that inherent defects are the only cause of the CAB's failings. These may, for example, also reflect the human tend-

ency to listen more closely to representatives, such as those for the industry, who are powerful, well-informed, and can reward regulators with future jobs or contracts. Or they may reflect the variety of political forces that the regulator must often take into account. Nor is it to say that classical regulation is always undesirable. In the case of some industries, it may be necessary. Yet classical regulation is not an appropriate tool for dealing with the problems of the airline industry. Defects in airline regulation run so deep that major change is required. Rather, reliance upon strong safety regulation, the antitrust laws to prevent predatory behavior, and the competitive process is more appropriate. Thus, a program of gradual, measured change toward increased reliance upon competition is called for.

The subcommittee's recommendations are designed to move gradually towards a system that increasingly relies upon competition, rather than classical regulation, to bring about low fares. They include the following:

In the area of route awards:

1. Major shifts in Board policy should take place only after adequate opportunity is given both to members of the industry and the general public to submit views and arguments.

2. A summary judgment procedure should be developed to replace the motion for expedited hearing.

3. Standards governing ex parte communications should be revised.

4. Strict time limits governing route cases should be developed and enforced.

5. The "route moratorium" should be officially terminated.

6. A program of gradually liberalizing entry requirements should be adopted. Such a program might 1) immediately allow the removal of route restrictions and begin to count an offer to lower fares as a factor in favor of granting a route; 2) immediately liberalize charter rules; 3) after an interim period allow any carrier to fly a route segment connecting with its present system on a showing that is is "fit, willing, and able" to do so; 4) allow supplemental carriers to do the same; and 5) eventually allow any firm wishing to supply air service on a route to do so on a showing that it is "fit, willing, and able."

In the area of rates:

1. Allow carriers flexibility to charge the prices they desire. The Board should retain a rate ceiling, but no floor, removing the ceiling only when entry rules become sufficiently liberal for the threat of new competition to hold prices down.

2. Liberalize restrictions on charter travel.

3. Allow the carriers wide lattitude to introduce systems of price discounts that reflect cost differences.

Antitrust immunity:

1. Adopt a standard that would prohibit any act that would violate the antitrust laws unless the anticompetitive effects are clearly outweighted in the public interest by the need to secure a significant transportation objective.

2. Establish liaison with the Department of Justice and the Department of Transportation so as to make appropriate use of their expertise in resolving these questions.

3. Develop standards for determining when hearings shall be given before granting requests for antitrust immunity. The standards should provide for hearings in controversial cases.

Enforcement:

1. Develop a procedure for allocating enforcement resources that does not depend entirely upon responding to complaints.

2. Assign a significant number of personnel the job of enforcing consumer oriented regulations.

3. Increase the budget of the Office of Consumer Advocate and consider an expanded program of consumer protection including, possible strict liability rules governing lost or damaged luggage, voluntary bumping systems, requirements that passengers already holding tickets be told of possible savings through fare reductions, spot checks on fare quotations to help stop overcharging, the development of a method by which airline ticket salesmen can speedily inform callers of low cost promotional, or other low cost, fares.

The subcommittee also recommends legislation designed to achieve these basic objectives.

AIRLINE REGULATION BY THE CIVIL AERONAUTICS BOARD

REPORT OF THE SENATE SUBCOMMITTEE ON ADMINISTRATIVE PRACTICE AND PROCEDURE

In November 1974 and February and March 1975, the Senate Subcommittee on Administrative Practice and Procedure held 10 days of hearings concerning the practices and procedures followed by the Civil Aeronautics Board (CAB) in the regulation of airlines.[1]

The subcommittee's inquiry was prompted by several considerations: During 1974, a time of rescession, air fares rose dramatically. At the same time, fares on flights wholly within Texas and California—where the CAB does not regulate intrastate flights—were apparently 30 to 50 percent lower than elsewhere in the country. Some critics of the CAB claimed that high fares in part reflected CAB hostility to new airlines which promised better service at lower prices. They claimed that the CAB had imposed an unlawful "moratorium" on competitive route hearings. Others alleged that airline service had deteriorated in part because the CAB had approved, without adequate hearings, interairline agreements to limit flights. Smaller airlines and air travel clubs had complained that CAB enforcement favored large carriers. Finally, the last few years have seen the widespread growth of well-informed, sophisticated, skeptical questioning of the basic way in which economic regulation is carried out by many governmental regulatory bodies.

Traditionally, of course, Americans have believed that the fairest, most effective process for establishing prices and allocating trade is open, healthy competition among companies vying for the public's patronage. This process is fair to the companies themselves because each has an equal opportunity to succeed and prosper. The process is also fair to the public, for the public receives exactly what it is willing to pay for; it always may demand another service at a different price. Furthermore, the resulting price is fair, for an unfairly high price will be undercut by another company or attract a new company willing to do business for a reasonable profit: The price is fair because the competitive process is fundamentally fair.

Experience has taught, however, that not all industries can sustain healthy competition, nor will competition always serve the public's needs. Thus, Congress and Government agencies have created a variety of forms of regulation, including the classical price and profit regulation practiced by the Civil Aeronautics Board. Under full-fledged, classical regulation prices and services are determined not by competition, but by agency judgment about fair costs, fair services,

[1] The 8 days of hearings held in February and March concerned the regulation of domestic airlines. The 2 days of hearings held in November 1974 concerned the efforts of several Government agencies to set minimum charter rates for international airline travel. A separate report has been issued on those hearings. See *Procedures Relating to Minimum Charter Air Fares*, Subcommittee on Administrative Practice and Procedure, Senate Committee on the Judiciary, staff report, committee print, 93d Cong., 2d sess. (1974).

fair profits, and fair industry practices. These judgments are made subject to statutory and agency substantive guidelines and in accordance with procedures established by the Administrative Procedure Act and, in the case of the CAB, the procedural sections of the Federal Aviation Act. These procedures conform to the traditional American model of adversary presentation of evidence and argument before an impartial judge.

In order to evaluate the CAB's practices and procedures thoroughly, Congress must apply standards of effectiveness, as well as the traditional standards of procedural fairness. Thus the basic question becomes whether the present system of classical regulation works better than a more flexible regulatory system that relies more heavily upon the competitive marketplace. The subcommittee's object throughout its hearings therefore was twofold: First, it sought to determine whether the Board's practices and procedures are fair. Are the Board's decisions made openly, after adequate opportunity for affected persons with differing views to present their proofs and arguments? Are those decisions based upon evidence in the public record?

Second, it sought to determine whether the Board's practices and procedures are effective. To what extent have they led to "adequate, economical, and efficient service by air carriers at reasonable charges?" [2] Have they both encouraged the growth of a healthy aviation industry capable of satisfying the Nation's need for air service, and made that service available to the traveling public "at the lowest cost consistent with the furnishing of such service"? [3]

During the course of its hearings, the subcommittee examined the major issues related to the Board's route policy, its ratesetting policies, its enforcement policies, and its antitrust policies. It heard from 72 witnesses,[4] including representatives of 6 of the 10 major trunk carriers,[5] two local-service carriers, the supplemental carriers, California and Texas airlines, the Airline Pilots Association, the Airport Operators Council International, representatives of various cities and towns, representatives of consumer organizations, the Department of Transportation, the Department of Justice, the Federal Trade Commission, the Council on Wage and Price Stability, the Council of Economic Advisers, and the CAB members themselves on five separate occasions (see appendix A).

In addition, the airlines have significantly aided the subcommittee's inquiry by providing answers to an extensive questionnaire. The Board too has provided answers to a questionnaire, as well as other written material. A series of reports was prepared by outside independent experts. Testimony was heard over the course of 10 days.[6] An earlier draft of this report was circulated to all interested parties for comments, in light of which the report has been revised.

The basic question, repeatedly discussed at the hearings, was whether increased reliance upon competitive market forces would bring about cheaper, more efficient airline service. The Board's present reliance upon classical route-award and ratemaking proce-

[2] Federal Aviation Act, sec. 102(c), 49 U.S.C. 1302.
[3] Federal Aviation Act, sec. 1002(e)(2), 49 U.S.C. 1482.
[4] This figure includes witnesses heard at the minimum charter rate hearings in November 1974, and those heard on March 21.
[5] Altogether it heard testimony from the major trunk carriers on 13 separate occasions.
[6] Including 2 days in November on the subject of minimum charter rates.

dures, it was argued, leads to fares that are too high. But these high fares do not produce exorbitant industry profits. Rather, since the industry is basically competitive, a high fixed fare leads the airlines to compete away any "excess" profit by providing more and more flights in ever emptier planes. As the CAB has stated, "the higher the fare level in relation to cost, the more capacity carriers will offer and the lower load factors will be." [7]

And, for similar reasons, lower fares would mean fuller planes and might mean fewer flights. In the view of the Board's critics, greater reliance upon competition would lead to lower, more cost-related rates, would reduce excess capacity, would improve the industry's economic efficiency, and would provide the air traveling public with a wider range of service and price choices.[8]

In opening one day of subcommittee hearings, Senator Kennedy stated that:

> The airline passenger these days can get free drinks on coach or a piano bar in the lounge. He can fly a "yellowbird" or other designer-colored airplane, and can choose menus and movies. He can "fly Carol to Miami" or content himself in someone else's "friendly skies." But one thing he cannot do is fly cheaply. He may choose between airlines, but he cannot choose between air fares. A lot of people believe that the Federal Government is responsible. And they may be right.
>
> The difference between low air fares and high air fares should not be the difference between the absence and presence of Federal regulation. If it is, then we must be prepared to overhaul regulation and make it more responsive to the citizens it is intended to serve.[8a]

Both the Board and industry representatives recognized that it is undesirable to fly half-empty planes. They nevertheless fear that too much reliance upon competition, in place of the "regulated competition" that the Board now allows, might severely injure the industry and impair its ability to provide an adequate air service.

This theme—whether competition is more likely to bring about cheaper, more efficient service or seriously to impair existing service—underlies most of the discussion about and evaluation of the host of individual issues upon which the subcommittee focused. The Board's critics tend to believe that increased reliance upon competition would not only prove more effective, but would also cure much of the unfairnesses found in the Board's present procedures. The Board's defenders tend to believe that imperfections in the Board's procedures or policies can be cured with minor, not major, changes.

Based upon the body of written and oral material submitted to it, the subcommittee has reached five general conclusions concerning the practices and procedures of the Civil Aeronautics Board during the past few years:

1. The Board's practices, however effective they may have been in promoting industry growth, technological improvement, and reasonable industry profits, have not been effective in maintaining low prices. It is economically and technological possible to provide present air service at significantly lower cost bringing long distance air travel within the reach of the pocketbook of the average American citizen.

2. Several of the procedures that the Board uses to set major Board policies—in particular, route and enforcement policies—have

[7] CAB Order 71-4-54, at p. 23.

[8] The number of flights might increase if the lower fares produce more travel. See, pp.46-48, infra.

[8a] Hearings of the Subcommittee on Administrative Practice and Procedure, of the Committee on the Judiciary, U.S. Senate, on Civil Aeronautics Board Practices and Procedures, Feb.-Mar. 1975, 94th Cong., 1st sess., at pp. 443-444 (hereinafter referred to as "Hearings").

lacked the openness, intelligibility, and impartiality required by elementary notions of procedural fairness.

3. The CAB should shift the focus of its attention from the problem of promoting the growth of the aviation industry—a goal that is consistent with large numbers of aircraft, frequently scheduled service, and comparatively empty airplanes—to the problem of making that service economically available to more of the American public—a goal that is consistent with fuller planes, reasonably frequent service, and significantly lower fares. The subcommittee believes that the procedures of the Board—to a large extent procedure that have classically accompanied traditional price and profit regulation—are ill-suited to achieving this goal. Rather, it will be necessary to rely to a greater extent than in the past upon market forces; it will be necessary to encourage greater price competition, to adopt a more liberal entry policy, and to use the power to grant immunity from the antitrust laws more sparingly.

4. In order to secure the adoption of these policies, the Congress should enact legislation designed to limit the power of the CAB to control prices, to restrict entry, and to confer antitrust immunity.

5. Since the aviation industry has grown and matured in an environment of regulatory protection, a shift toward a policy that relies heavily upon competition must take place gradually, allowing an ample transition period for the industry to adjust. Thus the subcommittee's specific policy recommendations provide for measured, conservative initial changes, which will lead to greater change when, and as, the regulators and the industry learn to operate successfully within a more competitive environment.

Thus these conclusions bear out the observation of Senator Thurmond:

> The central thought to emerge from the testimony so far is that greater reliance on competitive market forces will improve the economic performance of the industry and result in lower rates, will reduce excess capacity, and will provide the consumer with a wider and more attractive range of service and price options.
>
> * * * * *
>
> A reduction on Government regulation is necessary.* * * I think my constituents would much prefer to have the right to choose to forego these frills in preference to lower prices.[5b]

The subcommittee did not focus on international aviation, air transport of freight, or the domestic subsidy program. Thus its record and conclusions do not purport to be addressed to these aspects of the Federal regulatory system.

The remainder of this report will set forth the evidentiary basis upon which these conclusions and recommendations rest. It is organized as follows:

Section I provides a brief background description of the aviation industry, a summary of how airline regulation works, and a short history of airline regulation.

Section II will summarize the basic evidence presented by those who favor, and those who oppose, increased reliance upon competition as a substitute for classical regulation. It will discuss the California and Texas experience, which shows that fuller-plane, lower-fare service can be provided, and which suggests that increased com-

[5b] Hearings at p. 1149.

petition will lead to such service. It will go on to discuss the theoretical and empirical evidence relating to the arguments of those who fear that such competition would lead to drastically curtailed service.

Section III will examine the present alternative—classical price, profit, and entry regulation as currently practiced by the Board. Part A will consider the Board's procedures and practices in granting route awards. Part B will consider ratemaking procedures. Part C will consider the Board's use of its authority to grant antitrust exemptions—particularly the use of that authority to encourage agreements among airlines to restrict the service they provide in particular markets. Part D will consider the Board's enforcement policies. Each part will end with a set of specific recommendations.

Section IV will first bring to bear the lessons learned from the prior discussion to reach several general conclusions and recommendations. It takes note of the four major policy options that might be followed in the future: (a) Continuing current CAB policies with certain minor modifications; (b) enacting legislation that would increase the CAB's power to control the level of service that the carriers offer; (c) increasing the use of discount fares in order to fill excess space on airplanes; (d) relying to a greater extent upon competitive market forces.

Its general conclusions reflect the view that the last of these is the most desirable and the most likely to offer the public the choice of fuller-plane, lower-fare service. The section goes on to summarize the subcommittee's specific administrative and legislative recommendations for change.

The subcommittee believes that the time to inaugurate these changes is now, for two basic reasons: First, the evidence described in sections II and III, taken together, provides a powerful case for major change. Section III (pp. 77–176), reviewing how economic regulation has actually been practiced by the Board, shows that the classical practices and procedures the Board has followed—as applied to the competitively structured airline industry—are so deeply and fundamentally flawed that basically different methods must be tried. At the same time, section II indicates that a system relying more heavily upon increased competition presents a practical, effective alternative. Experience with such systems has proved generally satisfactory. And, the risks associated with the gradual introduction of such a system are small. Most importantly, the evidence suggests that the major fear of those who oppose a more competitive system—that its introduction will mean the end of service to many small communities—is unwarranted and that increased competition is unlikely to reduce such service significantly.[9]

Second, the subcommittee has made extensive efforts to assure that the evidence upon which its conclusions rest is accurate and comprehensive. Thanks to the active cooperation of the Board, the executive branch, the industry, members of the financial community, consumer groups, and others, the subcommittee not only heard many different points of view, but also obtained the factual information underlying them. These parties also received, commented upon, and corrected an earlier draft of the subcommittee's report. Thus, disagreement with the subcommittee's conclusions should not reflect a different source of information or a disagreement with the facts, so much as it

[9] See pp. 63–73, infra

may reflect a difference of opinion about the significance or implications of those facts.[10] Such differences are unlikely to be resolved by efforts to obtain still more information.

Finally, the facts and figures contained in this report are based upon the state of the industry, the economy, and regulation as the subcommittee found them last in the spring of 1975. In the subcommittee's view, it would be impractical, and perhaps misleading, to reflect in the report those changes in regulation that have taken place since, or partly in response to, criticisms voiced at the hearings.

[10] Thus the report and the hearing record contain a sufficient base of factual information for the reader to draw his own policy conclusions.

I. BACKGROUND

A. THE INDUSTRY

More than 90 percent of all scheduled airline service in the United States [11] is provided by the 10 major trunk carriers.[12] About 8 percent is provided by local service carriers.[13] Air service, unregulated by the CAB, is also provided by scheduled carriers operating wholly within the states of California and Texas,[14] as well as by a number of commuter carriers operating small airplanes. In addition there are eight supplemental carriers which provide solely charter service.[15]

The scheduled lines provide service to about 430 cities. Mathematical permutations and combinations of this number of points shows that there are more than 90,000 theoretically possible city-pair markets within the contiguous 48 states. Of these, approximately 58,000 receive certificated carrier scheduled service.[16] More than 70 percent of all passenger-miles, however, are flown between 908 city-pairs, and the largest 145 markets account for about 40 percent of all service.[17]

Since 1938, when CAB regulation began, the industry has grown enormously. Revenue passenger-miles have increased from 476 million to 114 billion.[18] Investment has grown from about $30 million in 1938 to over $7 billion today.[19] At the same time, in real dollar terms, airline fares have fallen significantly.[20] In 1938, 16 trunk carriers were operating. The 10 present trunk carriers have all operated since 1938; the other six carriers operating then have since merged with the presently existing 10. The route networks of the existing trunk carriers have grown extensively since 1938. But, no new trunk carrier has been allowed to enter the domestic industry.

B. THE REGULATORY FRAMEWORK

The Civil Aeronautics Board practices economic regulation; it regulates the prices charged by interstate airlines and entry into that industry. Safety is regulated not by the Board, but by the Federal Aviation Administration. This report does not concern safety regulation.

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[11] Excluding Alaska and Hawaii and unregulated air carriage.

[12] These carriers include the following: United, TWA, American, Eastern, Continental, Braniff, Delta, National, Western, Northwest. The other major U.S. carrier, Pan American, now provides international service almost exclusively.

[13] There are nine local service carriers. Most of them were admitted to the industry by the CAB in the forties. They include: Air New England, Air West, Allegheny, Frontier, North Central, Ozark, Piedmont, Southern, Texas International.

[14] Intrastate carriers operate in Florida and Illinois as well.

[15] These include Ovrseas National Airways, Trans International Airways, World, Saturn, and Capital, and three smaller carriers: McCulloch International, Modern Air Transport, and Johnson Flying Service.

[16] See staff study by the Bureau of Operating Rights, the Domestic Route System, Analysis and Policy Recommendations, October 1974, p. 1, [hereinafter referred to as BOR study]; Air Transport Association testimony, Feb. 6, 1974, exhibit 8, Hearings at p. 136.

[17] Ibid.

[18] BOR study appendix 8, table 1.

[19] BOR study table 1, p. 16.

[20] The average fare per passenger mile has fallen from $0.052 in 1938 to $0.018 in 1974 (constant 1938 dollars). See ATA testimony, exhibit 1. Hearings at p. 129.

The Civil Aeronautics Act of 1938, the precursor of today's Federal Aviation Act, was designed primarily to unify various Federal activities which were aimed at subsidizing an infant airline industry. The Act provided the CAB's present authority: to regulate rates, to grant "certificates of convenience and necessity" allowing firms to fly, to grant immunity from the antitrust laws, and to control mergers.[21]

These regulatory provisions were modeled after the 1887 statute providing the Interstate Commerce Commission with authority to regulate railroads.[22] That Act, in turn, was modeled after the British Railway Act of 1845.[23] These provisions have come to be regarded as creating "classical" price and entry regulation. They include: 1) a requirement that the Board allow a firm to provide service—to enter the industry—if the "applicant is fit, willing, and able to perform such transportation properly * * * and that such transportation is required by the public convenience and necessity";[24] and 2) a requirement that rates and practices of the air carriers shall be just, reasonable, and nondiscriminatory.[25]

The act provides the Civil Aeronautics Board with several highly generalized standards to guide it in carrying out its duties. These standards have often been characterized as requiring the Board both to promote the industry and to regulate it. For example, section 102 of the Act states that the Board in carrying out its duties shall take into account "the encouragement and development of an air transportation system properly adapted to the present and future needs of the foreign and domestic commerce of the United States," as well as "the provision of adequate, economical, and efficient service by air carriers at reasonable charges without unjust discriminations," and "competition to the extent necessary to assure the sound development of an air transportation system."[26] In addition, the Board is instructed when setting rates, to consider, among other things—

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[21] Much of the Act, however, concerns granting of subsidies by the Government to airlines.

[22] See C. S. Rhyne, *The Civil Aeronautics Act Annotated*, pp. 124–25 (1939).

[23] Compare 49 U.S.C. 1373B, 1374B with 49 U.S.C. 2, 3(1); 8 Vict. Ch. 20 (1845); 17, 18 Vict. Ch. 31 (1854).

[24] Section 401(d)(1), 72 Stat. 754, as amended by 76 Stat. 143, 82 Stat. 867, 49 U.S.C. 1371:

The Board shall issue a certificate authorizing the whole or any part of the transportation covered by the application, if it finds that the applicant is fit, willing, and able to perform such transportation properly and to conform to the provisions of this chapter and the rules, regulations, and requirements of the Board hereunder, and that such transportation is required by the public convenience and necessity; otherwise such application shall be denied.

[25] Section 1002(d), 72 Stat. 788, 49 U.S.C. 1482:

Whenever, after notice and hearing, upon complaint, or upon its own initiative, the Board shall be of the opinion that any individual or joint rate, fare, or charge demanded, charged, collected or received by any air carrier for interstate or overseas air transportation, or any classification, rule, regulation, or practice affecting such rate, fare, or charge, or the value of the service thereunder, is or will be unjust or unreasonable, or unjustly discriminatory, or unduly preferential, or unduly prejudicial, the Board shall determine and prescribe the lawful rate, fare, or charge (or the maximum or minimum, or the maximum and minimum thereof) thereafter to be demanded, charged, collected, or received, or the lawful classification, rule, regulation, or practice thereafter to be made effective: *Provided*, That as to rates, fares, and charges for overseas air transportation, the Board shall determine and prescribe only a just and reasonable maximum or minimum, or maximum and minimum rate, fare, or charge.

[26] 72 Stat. 740, 49 U.S.C. 1302:

In the exercise and performance of its powers and duties under this chapter, the Board shall consider the following, among other things, as being in the public interest, and in accordance with the public convenience and necessity:

(a) The encouragement and development of an air-transportation system properly adapted to the present and future needs of the foreign and domestic commerce of the United States, of the Postal Service, and of the national defense;

(b) The regulation of air transportation in such manner as to recognize and preserve the inherent advantages of, assure the highest degree of safety in, and foster sound economic conditions in, such transportation, and to improve the relations between, and coordinate transportation by, air carriers;

(c) The promotion of adequate, economical, and efficient service by air carriers at reasonable charges, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices;

(d) Competition to the extent necessary to assure the sound development of an air-transportation system properly adapted to the needs of the foreign and domestic commerce of the United States, of the Postal Service, and of the national defense;

(e) The promotion of safety in air commerce; and

(f) The promotion, encouragement, and development of civil aeronautics.

The need in the public interest for adequate and efficient transportation of persons and property by air carriers at the lowest cost consistent with the furnishing of such service, . . . and the need of each air carrier for revenues sufficient to enable such air carrier under honest, economical and efficient management to provide adequate and efficient air carrier service.[27]

The procedures that the Board must follow are to some extent specified by the Federal Aviation Act itself and more generally are contained in the Administrative Procedure Act and the relevant judicial precedents. Rather than evaluating the Board's performance in terms of its ability to conform its actions to all the highly general and potentially conflicting standards contained anywhere in the statute, the subcommittee proceeds in the belief that the *most basic part of the Board's mandate is to see that low cost*, efficient air transportation is provided to the public by a healthy, industry [28] and that the Board must act within the procedural constraints imposed by the Administrative Procedure Act.[29]

C. THE ORIGINS OF CAB REGULATION

The early history and development of airline regulation is noteworthy primarily because it does not shed much light on what would, or would not, happen in the future if increased reliance upon competition is substituted for classical regulation. There was neither a "golden age"—nor a "dark age"—of unfettered competition succeeded by the introduction of regulation in 1938. Rather, ever since the Wright brothers flight in 1903, the structure and behavior of the aviation industry have been shaped to a large extent by a combination of Government subsidy and Government regulation.

The conclusions that emerge from a brief examination of that history are: (1) The structure of the industry in 1938—a few large airline systems and several smaller systems—was more a result of administration of a Government subsidy system than of natural market forces. That industry structure has been preserved to the present time, in large part through restrictive CAB entry policies.

(2) There was never a period in which market forces led to "destructive competition" or "industry chaos." Rather, the administration of the system of Government subsidy, not market forces, brought about

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[27] Section 1002(c), 72 Stat. 788, 49 U.S.C. 1482:

In exercising and performing its powers and duties with respect to the the determination of rates for the carriage of persons or property, the Board shall take into consideration, among other factors—

(1) The effect of such rates upon the movement of traffic;

(2) The need in the public interest of adequate and efficient transportation of persons and property by air carriers at the lowest cost consistent with the furnishing of such service;

(3) Such standards respecting the character and quality of service to be rendered by air carriers as may be prescribed by or pursuant to law;

(4) The inherent advantages of transportation by aircraft; and

(5) The need of each air carrier for revenue sufficient to enable such air carrier, under honest, economical, and efficient management, to provide adequate and efficient air carrier service.

[28] The subcommittee, in setting forth this simplifying assumption at this stage of the report, does not mean to ignore other objectives often viewed as desirable regulatory goals, such as safety, energy conservation, environmental protection, development of the industry, development of commerce, postal needs, and national defense needs. Some of these objectives are subsumed in the mandate as set out in the text. Other objectives are discussed throughout the report as they become relevant to the particular policy matter considered. In general, the subcommittee believes that its recommendations, by leading to more efficient use of aircraft, would tend to further such objectives as conserving energy and protecting the environment. Its recommendations would have little significant effect upon such objectives as safety, the national defense, or the postal service. In general, there is at least as much reason to believe that the subcommittee's recommendations, by bringing about lower air fares, would stimulate industry development and local commerce as to believe the contrary.

Close analysis of some of these other objectives would shed little light on the merits of the policy choices actually at issue; consideration of others inevitably turns upon highly speculative, and directly conflicting, predictions about the future. Thus, to list them all at the outset, as if the Board's work could not be evaluated until considered totally in the light of each of them (rather than considering the Board's work in light of the major objective listed in the text, while bringing in these other objectives only when they have significant bearing) would confuse the main argument and understate the need for regulatory change.

[29] 5 U.S.C. 551–559, 701–706.

the cited instances of "destructively competitive" behavior in the midthirties.

(3) The legislative history of the Federal Aviation Act indicates that Congress intended not to allow the industry to remain the exclusive preserve of those firms doing business in 1938—that Congress, while suspicious of too much competition, intended more new entry and greater competition than the CAB has in fact allowed.

(4) However successful the CAB may have been since 1938 in promoting the development of the industry and of air services, it has been less successful in maintaining fares at a level that the average American can afford.

The history and development of CAB regulation is set out in detail in appendix B. That history will be briefly summarized in this section.

1. Pre-1925: Infancy.

Prior to 1925 aviation was in its infancy. Despite the Wright brothers' flight, Americans tended to be less enthusiastic about the possibilities of aviation than their European counterparts—at least until America's entry into World War I. Congress then appropriated $640 million for an aviation program. After the war, with the help of the Army, the Post Office organized an airmail service, which was instituted (from New York to Philadelphia) on August 12, 1918. Aviation technology then expanded rapidly with the assistance of Army and Post Office funds. Still, a private aviation industry did not appear commercially possible until 1925, when technology developed to where carriage of mail and light packages seemed potentially profitable.

2. 1925–34: Subsidy.

The history of American civil aviation effectively begins with the passage of the Kelly Act in February 1925. That Act provided for the Postmaster General to contract with private firms to carry the mail. Payment was initially limited to four-fifths of the revenue derived from airmail postage. In 1926, Congress made the carriage of airmail more attractive, first by providing public funds for the development of airports and navigation equipment and, second, by introducing a new system of compensation that effectively cut the tie between payments to the airlines and postage rates. The Post Office was thus freed to subsidize the airlines directly.

In early 1927, the Postmaster General took advantage of the new law to cut airmail postage rates. The lower rates increased mail volume and made the airmail system 75 percent self-supporting. In 1928, however, Postmaster General New cut rates again, this time without disturbing the contracts for airline compensation. The result was that airmail volume increased 95 percent, carriage costs stayed roughly the same (for the airplanes had extra space), and net airline revenues nearly doubled. A political storm broke as several airlines received large "excess profits"; at the same time other airlines (with different routes and costs) were highly unprofitable.

Because of this and other defects in the compensation scheme, in 1930 Congress revised the subsidy system. The new law changed the

basis for calculating compensation; it allowed the Postmaster General to award 10-year contracts and to renegotiate rates periodically; it insisted upon competitive bidding; but it permitted the Postmaster General, without competitive bidding, to add length to a short route, turning a carrier's existing short airmail route into a longer one.

Postmaster General Brown immediately began to use his new powers to forge a more unified air transport system comprised of a few large companies. In 1929 the government's 24 airmail contracts were distributed among 19 firms; by 1933, 18 of the government's 20 contracts were held by three large holding groups (which later became today's "Big Four": United, American, TWA, and Eastern). The Postmaster General used the promise of contract awards to encourage mergers; he tended to award contracts to large firms often simply by extending their routes and sometimes by ignoring lower bids. Some of the large firms bought out smaller competitors that might otherwise have underbid them; and large firms, strengthened by airmail subsidies, enjoyed financial advantages over their less well subsidized, smaller rivals. These factors, and various financial considerations, seem to have been more responsible for the concentration of routes among the "Big Four" in 1938 than any natural attrition induced by economic forces.

In using his subsidy powers to the advantage of the larger firms, the Postmaster General often evaded, or ignored, competitive bidding requirements. As a result Senator Hugo Black began an extensive congressional investigation. That investigation led to such widespread dissatisfaction with the subsidy system that President Roosevelt canceled all contracts and ordered the Army to carry the mail. When Army carriage proved unworkable, the President asked for temporary emergency bids, pending new legislation. The three large holding companies could not be challenged on most long routes, but shorter routes fell into the hands of a number of smaller companies. The airmail system that emerged just after these 1934 bids strongly resembles the industry's structure today.

3. 1934–38: Transition.

In 1934 and 1935 Congress enacted provisional reform legislation, containing the following significant provisions: (1) Holding companies were made unlawful. United and American were reorganized and shorn of their manufacturing connections. (2) A commission was established to study air transport and recommend legislation. (3) Strict competitive bidding was mandated; but existing airmail contracts could be extended without new bids, and the Interstate Commerce Commission was authorized to change the rates of compensation (up or down) under existing contracts.

The years 1934–38 were difficult for the industry. Profits were low and investment fell. Bids to carry the mail were so low that they have led to the claim that without regulation the industry would be characterized by predatory, below cost, pricing. Yet, these low bids resulted not from industry structure so much as from the 1935 legislation itself. As Colonel Gorrell, president of the Air Transport Association, stated:

> The law puts a premium upon an unreasonable low bid, since there is always the possibility that, later on, a rate first put unjustifiably low will be raised by the

action of the Interstate Commerce Commission. In other words, if an air carrier is in a relatively strong financial position, it can afford to bid at a figure far below what may be reasonable, since the Commission is ultimately under the duty of fixing a reasonable rate.[30]

The low profits and poor investment record in this period seem to have reflected, in part, public disenchantment with the industry as a result of the Black hearings and a poor safety record; in part, a consequent belief that Congress would not continue the previously high level of subsidy; and in part, the general depressed economic climate of the times.

The Federal Aviation Commission, established by Congress in 1934, reported back in 1935 recommending the creation of an independent regulatory agency modeled after the Interstate Commerce Commission. After 3 years of debate and modification, in 1938 the Civil Aeronautics Act became law.

The legislative history of the 1938 act suggests an ambivalent attitude towards competition. For one thing, the act's sponsors often expressed fear of too much competition. To some extent this fear rested upon the predictions of industry spokesmen that without regulation destructive competition would injure the airlines in the future. (There was no evidence of destructive competition in the past.) To a greater extent it may have reflected the more general fear of excess competition and suspicion of the competitive process prevalent during the Great Depression. Some in Congress blamed the competitive system for bringing about the depression, and many had voted for the National Industrial Recovery Act, which was an effort to stop "excess competition" in every major industry, not just airlines. At the same time, the act's sponsors made clear that the point of giving the Civil Aeronautics Board power to control competition, by limiting the ability of new firms to enter the industry, was that it use such power only insofar as entry threatened to destroy service over particular routes or threatened unsafe service. The CAB must use those powers only to protect existing service, not to protect existing firms. Statements of both Senator McCarran and Senator Truman, the act's primary senatorial supporters, reflect the sentiments set out in the study Commission's recommendation nine:

> There must be no arbitrary denial of the right of entry of newcomers in the field where they can make an adequate showing of their readiness to render a better public service than could otherwise be obtained. There must be no policy of a permanent freezing of the present air transport map with respect either to the location of its routes or the identity of their operators. The present operators of airlines have no inherent right to a monopoly of the routes that they serve.[31]

In fact, the legislative history suggests a congressional intent that as the industry matured, and became self-supporting, the Board would increasingly allow, and rely upon, new competition.

The net result was an act that set out a highly general aim—the development of an extensive, safe system of air travel at low fares—with somewhat ambivalent instructions as to how that result is to be achieved. The act provides the Civil Aeronautics Board with powers to control rates and entry and delegates to it the task of developing more specific policies designed to achieve the broad objectives.

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[30] Hearings on S. 2 and S. 1760 before a subcommittee of the Senate Committee on Interstate and Foreign Commerce, 75th Cong., 1st sess., at p. 464 (1937).

[31] Federal Aviation Commission, Report, recommendation 9 (1935).

4. Post-1938: Regulation.

This report will not attempt to deal with a history of CAB regulation here, even in summary fashion. The major events of airline history since 1938 are well known. The industry expanded considerably during World War II; and, after the war, the CAB for the first time allowed a number of new firms to enter the industry. These firms became today's regional and supplemental carriers. The 1950's saw the introduction and widespread use of coach fares. Jet service was adopted in the early 1960's and soon became predominant.

In the late 1960's the industry, relying upon its own and upon Government demand forecasts, ordered large numbers of new, wide-bodied jets. These forecasts, always difficult to make, were overly optimistic, with the result that in the early 1970's the industry found itself with considerable overcapacity.

With the exceptions previously noted for supplemental and regional carriers (which in part resulted from congressional legislation), the Board has allowed no new firm to enter the scheduled domestic industry. Entry policy, which for the past 20 years has been concerned with the question whether existing firms should be allowed new routes, was quite liberal during the mid-1960's but highly restrictive in the 1970's. Airline profits have been cyclical, with troughs (of 1 percent to 4 percent return on investment) in the early 1960's and early 1970's and peaks (of 12–14 percent) in the early 1950's and mid-1960's. Technological advance has been rapid, lowering costs and allowing fares, in real dollar terms, to fall well below 1938 levels. And, as previously mentioned, industry growth has been rapid and the expansion of air service has been extensive.

Indeed, no one could doubt that, judged by its effects, the CAB has been successful at promoting the development of air service and the aviation industry. In the subcommittee's view, however, the Board has not succeeded in carrying out its mandate to bring about such service at low fares—at fares as low as industry economics and technology permit and which will allow the widespread use of the American aviation system by the whole of the American public. This matter is the subject of the remainder of the Report.

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[32] With the possible exception of its recent certification of Air New England, formerly a commuter and now a regional carrier.

II. The Basic Argument: Should There Be More Competition?

The CAB's critics consistently recommended increased reliance upon competition as a substitute for classical price, profit, and entry regulation. Witnesses representing the U.S. Department of Transportation, the U.S. Department of Justice, the Federal Trade Commission, the President's Council of Economic Advisers, and the Council on Wage and Price Stability all called for increased price competition and greater freedom for new firms to enter the industry. Their approach was supported by representatives of the Texas Aeronautics Commission, the New York State Public Service Commission, consumer groups, and many others. Former Council of Economic Advisers member Merton J. Peck testified:

> [T]here is a general consensus among economists that airline regulation is not economically efficient [and a search for] . . . defenses by industry scholars of the present regulatory process . . . has been in vain.[33]

Indeed, at the President's recent "economic summit" conference on inflation, of 22 economists who took a position on transportation regulation, 21 argued for substantially increased reliance upon competition.[34]

Since this point of view is so widely shared among persons with very different backgrounds, since only major airlines and the Board itself disagreed, and since it underlies much criticism of the Board's behavior, it is desirable to explore the major arguments for and against increased reliance upon competition before looking closely at the Board's regulatory performance. Accordingly, this section will first set out the major argument why increased competition will significantly help the air traveler. It will then describe the empirical and practical evidence that supports that argument. Finally, it will describe and analyze the major arguments that the Board and the industry advanced against substituting increased reliance upon competition for the Board's present regulatory system.

It should be stressed, however, that the evidence discussed in this section does *not* on its own constitute the basis for the subcommittee's recommendations for change. Rather, it is the evidence of section III suggesting fundamental defects in the Board's present regulatory practices and procedures, taken together with section II's evidence, that has convinced the subcommittee that a new approach must be tried.[35] Section II's subject—the arguments for and against increased

[33] Hearings at p. 79.

[34] Hearings at p. 80 (testimony of Thomas G. Moore, senior fellow, Hoover Institution on War, Revolution, and Peace, Stanford University). These views were further corroborated by a search of the economic literature conducted for the subcommittee by Prof. Samuel Peltzman of the University of Chicago Graduate School of Business. Hearings at p. 2264.

[35] Section III's subparts each deal with a different area of Board procedure—the awarding of routes, the setting of rates, conferring antitrust exemptions, and enforcement. To evaluate fully and fairly the procedures and practices followed by the Board in each of these areas, one must understand the extent to which fairer, more effective alternatives are available. Thus, one must understand the arguments for, and against, increased reliance upon competition. Rather than discussing those basic arguments four separate times—under each area of Board practice and procedure—it is simpler and clearer to break out and to discuss the merits of the argument for greater reliance upon competition first, in section II, before section III's discussion of the effectiveness and fairness of the Board's present practices and procedures.

reliance upon competition—has been placed ahead of section III for increased clarity of exposition.

A. WHY INCREASED COMPETITION WILL HELP THE CONSUMER: THE THEORY

The basic argument in favor of increased reliance upon competition has three parts. *First*, the airline industry is not a "natural monopoly;" it is "structurally competitive." In some industries, which can support only one firm of efficient size in any one area, regulated monopoly is an efficient, effective way to serve the public intent. Without regulation, customers of such "natural monopolies" are at the mercy of the single firm supplying service. Telephone service and electricity production are often cited as examples. The airline industry, however, can support several, perhaps many, firms of efficient size.[36] In fact, larger airlines may have higher unit costs than many of their smaller competitors. Thus smaller airlines, such as Northwest and Continental operate profitably next to such giants as TWA.[37] United decided that it was too large and recently subdivided internally into three autonomous units.[38]

Since several different firms can afford to invest heavily enough to achieve efficient size,[39] while competing with each other, competition offers a possible alternative to regulation as a means of keeping prices low.

Second, to impose classical price and profit regulation upon an industry that is structurally competitive is dangerous, since regulation under those circumstances is inherently likely to produce high prices, overcapacity, and resulting waste. For one thing, regulators tend to place a heavy emphasis upon protecting the companies they are supposed to regulate. Regulation substitutes for an impersonal marketplace, which cannot be blamed for bankruptcies a regulator who can, and will, be blamed. Regulators feel keenly their statutory responsibility to see that adequate service is provided. They thus tend to distrust price competition, which threatens the financial health of the particular firms currently supplying service.[40] And, they tend to discourage such competition despite the fact that it can stimulate efficiency and bring about lower prices.

Furthermore, regulation of a competitively structured industry tends to raise costs: (1) by setting prices based on average cost, it prevents more efficient firms from taking business from the less efficient by undercutting their prices; and (2) the regulator tends to see decisions that preserve existing market shares of efficient and

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[36] The conclusion that economies of scale are not so great as to prevent the operation of several firms of efficient size is supported by the hearings, at p. 65 (prepared statement of Gary L. Seevers, member, Council of Economic Advisers, and James C. Miller, III, senior staff economist, CEA); p. 50 (prepared statement of Thomas E. Kauper, Assistant Attorney General, Antitrust Division, U.S. Department of Justice). A thorough search of the economic literature by Professor Peltzman reveals unanimity of view of this point. Hearings at p. 2264. In fact, the industry may be able to support as many as 200 efficient airline companies. Hearings at pp. 453–54 (testimony of William A. Jordan, professor of managerial economics, York University). See also, Douglas and Miller, *Economic Regulation of Domestic Air Transport: Theory and Policy*, p. 178 (1974).

[37] See Hearings at p. 1233 (testimony of Thomas D. Finney Jr., counsel, Continental Airlines).

[38] Hearings at p. 1214 (prepared statement of George Eads, assistant director, Council on Wage and Price Stability).

[39] See also Hearings at p. 576 ff. (testimony of Andrew De Voursney, United Air Lines, suggesting that capital costs, while high, are not so high that they prevent the entry of several different firms).

[40] Alfred E. Kahn, chairman of the New York Public Service Commission, explaining why regulators tend to be hostile toward competition, stated that they see competition as "disruptive and threatening. It interferes with orderly planning, it upsets stable markets; it is something to be restricted, confined, and prohibited." Hearings at p. 50.

inefficient firms alike as "fair" decisions, preserving the expectations of each of the firms before him.

Finally, classical regulation, by inhibiting price competition, simply encourages firms in a competitively structured industry to compete instead by offering more and more *service* (or advertising). The result is that the industry may wind up providing more service than consumers desire and charge higher prices for it. If technology reduces costs, as was true in the airline industry in the 1960's, competition will not drive a regulated price down to the level of cost. Instead:

> If competition is sufficiently strong potentially to drive price down to cost—and that [in the airline industry] is the reason for the regulatory restraints being imposed on competition in the first place—it would also ordinarily be sufficiently strong to induce suppliers, confronting a price above cost to seek other, nonprice methods of producing additional sales. . . . To the extent that competition continues to prevail it will tend to raise cost to the level of price.[41]

Thus airlines, confronting an historical price set by the CAB, compete by adding additional flights to their schedules, producing emptier airplanes and more frequent service. The extent to which this practice is wasteful depends upon how much consumers want more frequent service and how much they want lower prices. But, virtually every independent economic expert testifying before the subcommittee estimated that the existing level of service is wasteful. They estimate the unnecessary cost to the consumer at an unnecessary $1 billion [42] to $3.5 billion per year.[43]

Third, increased competition would force down prices and eliminate excess capacity. If carriers were free to set prices and if it were easy for a new firm to enter the industry (and for existing firms to obtain new routes), firms would experiment in offering consumers different combinations of price and service. Those which proved more popular would survive. Since most consumers naturally prefer lower fares, prices would be driven down. How would this work?

Suppose, for example, that an unregulated carrier flying between New York and Miami decided that consumers prefer lower-cost service and fuller planes. The carrier would cut its price, hoping to fill, its planes to the point where its higher load factors reduced costs earning a profit at the lower price. Of course its competitors might meet its lower price. Then one of two things will happen: 1) the lower fares may generate sufficient new traffic (because some of those who have not flown will now do so) to fill up *all* planes to the point at which, because of higher load factors, profits are earned at the lower price. If so, all is well. But 2), perhaps not enough new traffic will be generated. If so, the airlines would lose money. In the latter case, in order to avoid heavy losses, the airlines flying between New York and Miami would have to reduce the number of scheduled flights. They might each reduce service or the sustained losses might force one or more to cut out scheduled service entirely or even to leave the market. The net result would be lower fares and possibly somewhat reduced service. Even if one carrier were left with the predominate share of the market, that carrier would still hesitate to raise its prices since too high a price will attract back into the market its competitors which, in all probability, would be serving

[41] See Hearings at p. 97 (statement of Chairman Kahn). See also Douglas and Miller, supra, note 36, at chap. 4.
[42] Hearings at p. 64 (testimony of James Miller, Council of Economic Advisers).
[43] Hearings at p. 457 (testimony of Professor Jordan).

other routes nearby. As Acting Secretary of Transportation Barnum put it:

> You will get threshold pricing in these markets so that carriers who are in these markets will price at a level just high enough to discourage the other carriers able to come in from coming in.[43a]

In other words, a more flexible rate policy, and a freer entry policy, together—but not separately—would provide the air traveler with lower fares.

B. EMPIRICAL EVIDENCE

Experience in California and Texas, studies by Lockheed, Boeing, and others, and several other pieces of empirical evidence tend to confirm the 3-part argument just advanced. This evidence conclusively shows that airline service can be provided significantly cheaper in fuller planes and that most consumers would prefer such service.[44] It also indicates that increased reliance upon competition would bring about this full-plane, low-fare service.[44]

1. The California and Texas Experience.

Since the CAB does not regulate flights that do not cross state lines, experience with intrastate flights in California and Texas provides a useful test of the effects of CAB regulation. Though airlines in both states have always been subject to safety regulation,[45] flights wholly within California were subject to little economic regulation between 1949 and 1965.[46] Since 1971, Southwest Airlines in Texas has provided air service essentially free of the sort of detailed regulation that the CAB imposes.[47] Experience in California and Texas suggests that less regulation and more open competition would bring about safe air service with substantially lower fares, more frequent flights, and fewer frills.

a. Lower Fares

The relation between the fares charged by the Texas and California carriers and the fares charged by CAB carriers operating in reasonably similar markets is shown in table 1.

[43a] Hearings at p. 10.

[44] See pp. 55 for empirical evidence tending to confirm this part of the proposition. Of course, not all travelers want cheaper flights; many, whose schedules are important, or who are flying on expense accounts, would prefer frequent, uncrowded, high-fare service. The California and Texas airlines would presumably offer such service if they felt that sufficient numbers of passengers wanted it.

[45] See Hearings at p. 483 (prepared statement of William A. Jordan, professor of managerial economics, York University).

[46] Before the late sixties the California State Public Utilities Commission regulated safety and loosely administered a form of maximum price regulation. It began to control entry into the intrastate market in 1965. The regulation did not take effect, however, until 1967. Hearings at p. 464 (prepared statement of William A. Jordan, professor of managerial economics, York University.) Although one of the regulated carriers argued that state regulation was introduced because of a public demand for it, the evidence seems more persuasive that it was introduced either at the behest of, or with the tacit consent of, the existing carriers. Compare hearings pp. 587 (prepared statement of James Mitchell of Continental Airlines) with hearings pp. 601 (supplementary testimony of William A. Jordan). Several witnesses noted that since state regulation has taken effect, California's intrastate fares have increased. Pacific Southwest Airlines, the intrastate carrier, writes that these increases which began in 1969 are due to several factors, "including inflation, unionization, fuel increases, regulatory lag on fare relief, and new routes and operating restrictions." These factors "have resulted in fare increase requests well above those which would have been required with *less regulation or a more stable economy.*" Comments by PSA on subcommittee staff draft report, p. 3 (emphasis added).

[47] Although the Texas Aeronautics Commission has powers roughly similar to those of the CAB, it has allowed Southwest to enter Texas markets and to price roughly speaking, as it pleases. See Hearings at p. 1248 (testimony of M. Lamar Muse, president, Southwest Airlines); pp. 525–6 (testimony of Charles Murphy, executive director, Texas Aeronautics Commission).

The following table shows that the intrastate fares are approximately 50–70 percent of the CAB fares for approximately the same distances and kinds of routes. For example, a traveler in California can fly the 338 miles between San Francisco and Los Angeles for $18.75 and the 456 miles between San Francisco and San Diego for $26.21. A traveler flying between Boston and Washington (399 miles) must pay $41.67, between Dallas and New Orleans (442 miles) he must pay $44.44 and between Chicago and Minneapolis (338 miles) he must pay $38.89. Within Texas an air traveler can buy a coach seat for the 248 mile trip between Dallas and San Antonio for $23.15 during the day and $13.89 every weekend and after 7:00 p.m. each evening. But, to fly 191 miles, the Boston–New York passenger who crosses a state line must pay $24.07 for a coach seat no matter what time the plane departs during the day, and $19 at night.[48]

TABLE 1.—COMPARISON BETWEEN INTERSTATE AND INTRASTATE FARES

City-pair	Fare[1]	Miles[2]	Passengers transported[3]	Block time[4]
*Los Angeles-San Francisco	$18.75	338	[5] 7,483,419	:55
Chicago-Minneapolis	38.89	339	1,424,621	1:06
New York-Pittsburgh	37.96	335	975,344	1:05
*Los Angeles-San Diego	10.10	109	2,518,701	:30
*San Francisco-Sacramento	9.73	86	505,148	:30
Portland-Seattle	22.22	129	1,217,381	:35
*Los Angeles-Sacramento	20.47	373	915,077	1:00
Boston-Washington	41.67	399	981,456	1:07
Cleveland-New York	43.52	416	910,270	1:25
Chicago-Kansas City	37.96	404	813,235	1:10
Chicago-Pittsburgh	41.67	413	972,543	1:23
*San Francisco-San Diego	26.21	456	399,639	1:05
Detroit-Philadelphia	45.37	454	313,439	1:25
Dallas/Fort Worth-New Orleans	44.44	442	522,223	1:15
New York-Raleigh/Durham	44.44	423	267,272	1:15
Columbus-New York	47.22	478	294,682	1:18
*Dallas/Fort Worth-Houston	23.15/13.89	239	1,620,000	:50
*Dallas/Fort Worth-San Antonio	23.15/13.89	248	980,000	:50
Las Vegas-Los Angeles	28.70	236	1,181,466	:50
Chicago-St. Louis	29.63	258	953,604	:50
*Houston-San Antonio	23.15/13.89	191	490,000	:40
Boston-New York	24.07	191	2,493,882	:50
Reno-San Francisco	25.93	192	312,811	:46
Miami-Orlando	25.93	193	514,475	:40

*Intrastate market.

[1] Interstate markets: Coach fare. Intrastate markets: Economy fare. Source: "Official Airline Guide," Feb. 1, 1975.
[2] Source: Book of Official CAB Route Maps and Airport-to-Airport Mileages. Most entries are volume-weighted averages of two or more airport-to-airport mileages.
[3] Source: Interstate markets—CAB service segment data, special computer tabulation, reporting period from July 1, 1973 to June 30, 1974. Intrastate markets—California PUC form 1504 report, reporting period from Apr. 1, 1973 to Mar. 31, 1974.
[4] Average scheduled flight time. Source: Official Airline Guide, Feb. 1, 1975.
[5] California markets include traffic to and from suburban airports. Los Angeles-San Francisco includes 12 airport-pairs for example:

LAX–SFO	18.75	338	2,984,985	59.0	:55
ONT–SFO	20.47	363	334,208	60.2	:55

[48] In fact, Boston–Washington night coach service is so restricted that few passengers know it is available, only 0.5 percent of all Boston–Washington passengers flew night coach in 1974 (based upon a 10 percent sample), compared with 53 percent of Southwest's passengers, where night coach is an integral part of Southwest's fare system.

A more precise measure of flight time, available for some markets, is average block-to-block flight time:

TABLE 2.—INTERSTATE AND INTRASTATE ROUTE FLIGHT TIMES

City-pair	Block-to-block flight time	
	Certified	PSA
Los Angeles-San Francisco	1:06	0:59
Chicago-Minneapolis	1:14	----
New York-Pittsburgh	1:12	----
Los Angeles-San Diego	0:37	0:31
Portland-Seattle	0:37	----
Boston-New York	0:56	----
Los Angeles-Sacramento	1:07	1:01
Boston-Washington	1:16	----
Cleveland-New York	1:23	----
Chicago-Kansas City	1:17	----
Chicago-Pittsburgh	1:20	----
San Francisco-San Diego	1:14	1:07
Detroit-Philadelphia	1:26	----
Dallas Fort Worth-New Orleans	1:16	----
New York-Raleigh Durham	1:17	----
Columbus-New York	1:26	----

Source: Compiled by the subcommittee from data supplied by the FAA.

Although the absence of regulation in California and Texas appears to be responsible for low fares and more flights, the CAB and the certificated airlines claimed that California and Texas are "special cases." The subcommittee has tried to evaluate each of the "special" explanations of low intrastate fares that the airlines and Board have advanced. The subcommittee concludes that the "special" explanations are generally without merit. A short discussion of each of these proposed special conditions follows.

1) Weather conditions.—The carriers [49] and the CAB [50] argue that poorer weather conditions in the East raise costs. But, the differences in weather between, for example, Boston–Washington and San Francisco–Los Angeles cannot account for any significant portion of the differences in fares between them. The Federal Aviation Administration reports that weather conditions cause cancellation or delays [51] of less than 1 percent of all flights at Logan Field in Boston, National Airport in Washington, and all airports in the New York area.[52] No evidence was presented suggesting that weather accounted for more than a small fraction of the fare differential.

Although weather delays in the East were greater, the difference is insignificant. The Federal Aviation Administration also stated that in 1974, fog or weather factors created poor visibility (below 200 feet or

[49] Cf. Hearings at p. 402 (letter from John R. Summerfield, president, Summerfield Associates to the subcommittee, dated Feb. 28, 1975). Dr. Summerfield is an independent airline consultant. His letter is used to represent the claims of the carriers because it so well summarized similar claims made by many of the carriers separately and because much of that testimony was based upon a study that he made for the Air Transport Association.

[50] Hearings at p. 407 (testimony of William B. Caldwell, Jr., director Bureau of Operating Rights, CAB).

[51] The FAA's submission concerns delays of more than 30 minutes. Evidence concerning shorter delays was not available. The Board and the carriers were asked repeatedly to submit any evidence in their possession relevant to their claim that weather differences are highly significant. None was forthcoming.

[52] According to the Federal Aviation Administration, the fraction of all flights, including general aviation, delayed more than 30 minutes at key airports were:

	Percent
Los Angeles International Airport	0.13
San Francisco International Airport	.02
Logan Airport (Boston)	.34
National Airport (Washington)	.13

one-half mile) in Los Angeles for 228 hours as contrasted with 233 hours in Boston.

2) *Traffic density.*—The Board [53] and the air carriers [54] claimed that the fare differences can be largely explained by the lower cost of serving routes with high-traffic density. In other words, the fact that the Boston-Washington fare is more than twice as high as the San Francisco-Los Angeles fare may be accounted for by the fact that nearly 7 million passengers fly between San Francisco and Los Angeles while only 980,000 fly between Boston and Washington. Table 1 however shows that once a moderate traffic level is reached,[55] additional traffic density makes little, or no, cost difference. For example, the San Francisco-San Diego route supports 400,000 passengers, less than half the Boston–Washington traffic, yet the fare is $26.21, compared with the $41.67 charge from Boston to Washington. Los Angeles-Sacramento, a route of about equal distance and density with the Boston-Washington route, has a fare of $20.47, less than one-half the fare along the east coast.[56] Moreover, the differences in density do not explain the fact that the fares charged by the unregulated carriers are between $5–$6 lower than the fare charged by the interstate carriers to fly intrastate passengers over the identical route.

3) *Direction of traffic flow.*—The Civil Aeronautics Board pointed out that routes where traffic flow is highly seasonable or where traffic tends to flow primarily in one direction are more expensive to operate.[57] The subcommittee received no evidence suggesting that this factor explains the cost differences revealed in table 1.

4) *Congestion.*—The carriers [58] argue that many routes outside of California are more expensive to fly because of added congestion, both in the air and on the ground. The subcommittee has tried to evaluate the significance of this factor by examining ramp-to-ramp flight times. Added congestion either on the ground or in the air will have the effect of delaying flights and increasing the total time needed to travel between the ramps at two airports. Table 1 allows comparisons among routes that have roughly comparable ramp-to-ramp times. On a "time of flight" basis, with an average flying time of approximately 1 hour 5 minutes, the San Francisco–San Diego flight is comparable to the Boston–Washington flight, which, though shorter in distance, takes 1 hour 7 minutes on the average to fly. The Boston–Washington fare is nonetheless around 60 percent higher.[59] Moreover, the Civil Aeronautics Board estimated the "fare per minute"—a figure that should take congestion into account [60]—between Boston and Washington is 62.19 cents between San Francisco and Los Angeles it is 34.09 cents, and between Dallas and Houston it is about 46 cents during peak (27 cents offpeak).[61] Finally, congestion cannot

[53] Hearings at p. 495 (testimony of Richard J. O'Melia, Acting Chairman, CAB).

[54] Cf. Hearings at p. 493 (letter from Dr. John R. Summerfield, president, Summerfield Associates, dated Feb. 28, 1975. See Hearings at p. 590 (prepared statement of James L. Mitchell, Continental Airlines).

[55] See Hearings at pp. 452–59, 462–87 (testimony and prepared statement of Dr. William A. Jordan, professor of managerial economics, York University).

[56] Similarly, the fare from Ontario, California to San Francisco is $20.47. The distance is 363 miles, and the route serves 334,000 passengers per year.

[57] CAB response to subcommittee questionnaire, question 15.

[58] Hearings at p. 518.

[59] If ramp-to-ramp times are determined on a somewhat different basis as in footnote 5 of table 1, the time difference between the two routes is somewhat greater. Still, a 9-minute difference in flight time cannot explain more than a small portion of the 60-percent fare difference between these two routes.

[60] Hearings at p. 502.

[61] As with table 1, Southwest's offpeak fares are given prominence in the text because of their widespread availability and use. A 20-percent cheaper night coach is also available between Boston and Washington, but it is unpublished and used by fewer than 2 percent of that route's travelers. That rate per minute is 48 cents.

explain fare differences between the intrastate routes and those such as Los Vegas–Los Angeles, Portland–Seattle, or Dallas–New Orleans where there is no particular airport, or air, congestion problem. While, congestion may be a significant cost-factor at New York City airports, elsewhere it does not account for much of the fare differences.

5) Costs derived from interlining.—The carriers argue that, were PSA and other intrastate lines part of an integrated interairline network, they would have to bear heavy additional costs to maintain interconnected service. At the subcommittee's request, the Air Transport Association, the airline industry trade association, made available to the subcommittee a study by Dr. John Summerfield, an independent transportation expert whom the ATA had hired early in 1974 to determine what additional costs the intrastate carrier (PSA) would bear were it part of a complex interline network. Dr. Summerfield's study reached the following conclusions for the year 1974:

(a) If PSA were to sell passengers interline tickets for use outside California, the extra time needed to compute fares, the extra cost of writing the tickets, and the extra accounting involved would add approximately $11 million to PSA's reservations bill. (Dr. Summerfield's analysis, however, leaves out the fact that PSA's ability to sell interline space would generate extra revenue that would offset at least some of the extra cost.)

(b) If PSA were regulated by the CAB, filing tariff schedules and time tables would increase its cost by $250,000.

(c) If PSA served food, its costs would increase by $3 million.

(d) If PSA flew interstate, it would have to have extra flight crews at an added cost of between $1–3 million.

(e) Added complexities in transferring mail and other baggage would increase PSA's costs by nearly $2 million.

(f) Other differences in interstate flight crew requirements would add about $500,000 to PSA's cost.[62]

Dr. Summerfield concluded that these factors would add approximately $20 million per year to PSA's costs, approximately $3 per ticket. PSA stated that Dr. Summerfield's estimate of these added costs were too high.[63] Furthermore, Dr. Summerfield's analysis appears to overlook certain special costs incurred by PSA but not by the CAB carriers.[64] Nevertheless, assuming Dr. Summerfield's calculations are correct, he explains only about half of the difference between the PSA fares and the certificated carriers' "intrastate" fares over the same routes within California. More importantly, the $3 represents only a small fraction of the difference between the PSA fare and the CAB carriers' interstate fares revealed in table 1.

6) Differing aircraft types.—The Board pointed out that different costs are associated with different aircraft.[65] However, the interstate and intrastate airlines fly approximately similar aircraft—short-range

[62] See Hearings at p. 490 (testimony of Dr. John Summerfield).

[63] PSA states that unless it believed interlining would generate sufficient new revenue to cover its additional costs, it would not want to interline. Dr. Jordan adds that it would not need to pay an extra $1 million to $3 million for additional flight crews, for its flight crews are now based in San Diego and it therefore now bears substantial "overnighting" costs. PSA also believes Dr. Summerfield's baggage and transfer cost estimates are too high. (Letter from J. Floyd Andrews, chairman of the board and chief executive officer, Pacific Southwest Airlines, to Senator Kennedy, July 15, 1975.)

[64] The additional cost to PSA of selling interline reservations is probably overstated, because the ability to sell interline tickets would itself generate additional revenues for PSA. Moreover, PSA paid in 1974 approximately 3.2 cents per gallon more for gasoline than the trunk carriers, leaving PSA with a net cost disadvantage of $2 million.

[65] CAB response to the subcommittee questionnaire, question 22.

Boeing 727's and 737's, Douglas DC–9's, and BAC 111's—on all of the routes shown in table 1. Aircraft type does not seem to make a significant cost difference in these markets.

7) *The need to support other routes in the system.*—The airlines argue that they must charge a higher price on some routes to provide enough revenue to subsidize service on other routes. But the figures pertaining to the route that the subcommittee investigated in depth, Boston–Washington, indicate that the high fares currently charged there do not generate revenues available for cross-subsidy. American Airlines estimates its fully allocated cost for a Boston–Washington flight at $5,752 per trip. It now flies that trip at a load factor of about 55 percent, charging $42, and averaging revenues of $5,544.[66] (The question of whether there are many routes that earn large profits in order to subsidize other routes, or whether such cross subsidy should take place, is highly controversial. This complex matter is explored in detail in section IIIC where it is concluded that only a very limited amount of this type of cross subsidy now occurs.)

8) *The need to provide through service, rather than turnaround service.*—American Airlines pointed out that PSA can save money by not flying its planes "beyond" to serve other cities but instead operating a "turnaround" service. American has estimated that it would save approximately $400 per flight if it provided only turnaround service between Boston and Washington. Whether this factor provides a significant explanation of the difference between interstate and intrastate costs is doubtful, for, according to the CAB staff, such "turnaround" service accounts for about one-third of all interstate flights as well.[67] Moreover, PSA provides a certain amount of "beyond" service.[68] In any event, assuming that providing service "beyond" does raise costs $4–5 per ticket it is unclear why two-thirds of the planes' passengers flying between Boston and Washington who get off at each of these cities ought to pay $4–5 more in order to save the other one-third the inconvenience of changing planes.

9) *The major explanatory factors: Load factor and seating capacity.*—The largest part of the difference between intrastate airline fares and the CAB's fares appears to be due to the simple fact that the intrastate carriers put more passengers in their planes. For example, PSA puts 158 seats in a Boeing 727–200 jet aircraft and fills approximately 60 percent of these seats on average.[69] American Airlines puts 121 seats in the same plane and flies it on average 55 percent full.[70] Thus, when flying PSA, 95 passengers must share the cost of flying the airplane, while, on an American plane, 66 passengers must share the same cost.

This fact alone accounts for more than half of the fare differences shown in table 1. PSA can put more seats in its planes because it has no first-class section; it carries no closets or galley. PSA's lower fares then attract more passengers to the planes with more seats. American Airlines data (see table 3) shows that if American put 158 seats in its

[66] Hearings at pp. 1141–49 (letter from Randall Malin, vice president, marketing planning, American Airlines, to the subcommittee, Apr. 4, 1975). American's data assumes that it flies a 727–200 flying with 121 seats.

[67] BOR study at p. 64.

[68] PSA offers several "beyond" services. San Diego is served from Sacramento, San Jose, and Oakland via Los Angeles. Sacramento is served from Burbank, Ontario, and Long Beach via San Francisco.

[69] Hearings at p. 449 (prepared statement of Lawrence A. Guske, assistant controller, Pacific Southwest Airlines).

[70] Hearings at p. 522 (prepared statement of Randall Malin, vice president, marketing planning, American Airlines). Boeing has provided the subcommittee with a list of seating capacities for airlines of various types. The 727–200 has a maximum seating capacity of 163, but the CAB carriers put an average of 125 seats in the plane. The 737–200 has a maximum seating capacity of 115; the manufacturer recommends 100 seats; the CAB carriers put an average of 94 seats in the plane.

727-200's and filled its Boston-Washington planes 60 percent full, it could cover its $2,876 one-way cost by charging each of its 95 passengers $42, rather than $42, per trip. (If it also supplied "turnaround" service, the Boston-Washington fare could drop to about $28,[71] only slightly more than PSA's San Francisco-San Diego fare.)[72]

In addition, PSA's cost also may be lower because it makes more productive use of labor (though all wage rates are union scale).[73] After careful study of the California experience, Professor William Jordan estimated that by filling planes 70 percent full (as in California) instead of 55 percent full (as elsewhere), by obtaining labor productivity similar to that in California, and by keeping equipment in operation for somewhat longer, airlines throughout the Nation might save travelers nearly $3.5 billion per year.[74]

In sum, the subcommittee's investigation indicates that the basic reason why intrastate fares are lower is that intrastate airline's fly fuller planes. There is no economic or technical reason why such low-fare service cannot be provided elsewhere in the country as well.

TABLE 3.—FLIGHT COSTS ON SELECTED SEGMENTS [1]

[AMERICAN AIRLINES, INC.]

	Cost per round trip [2]	Cost per seat-mile (cents)	Cost per passenger mile (cents) [3]
Fully-allocated costs:			
New York to Los Angeles	$58,432	3.47	6.31
Chicago to New York	8,145	4.59	8.34
Boston to Washington	5,752	5.96	10.82
Direct operating costs:			
New York to Los Angeles	29,066	1.73	3.14
Chicago to New York	3,269	1.84	3.35
Boston to Washington	1,992	2.06	3.75
Incremental costs [4]			
New York to Los Angeles	42,557	2.53	4.60
Chicago to New York	6,256	3.53	6.41
Boston to Washington	4,470	4.63	8.41

[1] Based on 1973 unit costs increased by industry cost increases of 11.56 percent to June, 1974.
[2] 747 aircraft (340 seats) New York to Los Angeles, B727-200 aircraft (121 seats) on other segments.
[3] Passenger miles at 55 percent load factor.
[4] Total costs, excluding depreciation, sales and advertising, and general and administrative expense and return on investment.

Source: Letter to subcommittee from American Airlines, Apr. 4, 1975, Hearings at p. 1141.

b. More Frequent Service

The intrastate experience also suggests that the lower prices that new competitive airlines might charge could increase the number of flights available. This conclusion is necessarily somewhat more conjectural than that regarding the lowering of fares. While the two fare levels exist side-by-side, at any one time there is only one total number of passengers, and it is difficult to state with certainty how

[71] Hearings at pp. 1141-49 (letter from Randall Malin, vice president, marketing planning, American Airlines, to the Subcommittee, Apr. 4, 1975). Judging from Mr. Malin's prepared statement of Feb. 14, Hearings at p. 521, simplified ticketing and baggage handling could reduce costs another 21 percent to $26 per passenger.

[72] That American figures may show costs somewhat higher than average is suggested by the submission of the Airport Operators Council International, appendix E, Feb. 18, 1975, showing a cost of approximately $2,400 to fly a Boeing 727 for 1 hour 40 minutes, over a route of 653 miles. Hearings at p. 726.

[73] PSA, Air California and Southwest Airlines all stressed the fact that they pay union scale wages. For productivity comparisons, see Hearings at p. 480 (testimony of William A. Jordan).

[74] See Hearings at p. 457 (testimony of William A. Jordan). Professor Jordan derives a comparatively small amount of these savings ($315 million) from an assumption that airlines might depreciate their aircraft over 17 years (as PSA has done recently with a few of its planes), instead of 14 years (the current regulated airline practice).

many were stimulated to fly because of the lower fare and how many would have flown in any case. The best evidence comes from Texas where the recent entry of Southwest Airlines allows a contrast between service before and after new, lower-priced service was available. In the triangle of San Antonio, Dallas–Fort Worth, and Houston, traffic declined slightly during the 5 years prior to the beginning of Southwest's operations in 1971. Between 1971 and 1975, apparently because of Southwest's low fares, total traffic increased between 100 and 150 percent.[75] The increase in the number of passengers has been translated into an increase in the number of flights. Moreover, in the spring of 1975, Southwest Airlines extended its low-fare service to the Rio Grande Valley through the town of Harlingen. Within a few months, traffic out of Harlingen increased 173 percent over the comparable period the previous year.[76] In the Rio Grande Valley as a whole, the three carriers—Southwest, Braniff, and Texas International—have increased the number of flights daily from 37 to 61.[77]

Similarly, in California, lower fares appear to have generated new traffic to the point where they have brought about more frequent service, not less. A CAB staff study prepared in 1965 reported that PSA's low fares "have apparently expanded total traffic far above what it otherwise might have been."[78] In 1965, for example, Pacific Airlines, a subsidized CAB carrier,[79] was the only carrier providing single-plane service between San Jose and Los Angeles; it carried 56,000 passengers. In May 1966, PSA began low-fare service over that route; by 1967, the market had expanded to 557,000 passengers.[80] PSA also entered the Sacramento–Los Angeles market in 1967 with a 25-percent fare reduction; during that year, traffic on the route doubled.[81] Scheduled service consequently increased.

The lowering of fares and the increase in the frequency of intrastate flights has extended the opportunity to fly to many people who otherwise could not do so. Charles Murphy of the Texas Aeronautics Commission testified:

> I would suggest to you that someone from the Senator's staff visit the airports and observe the difference in the appearance of the people who utilize the $15 fare as opposed to the $25. These people are people who are coming to the airline instead of going to the bus. It is almost like they are getting ready to takeoff on some of the late flights and you kind of wait for them to tie the chicken coop on top of the airplane.
>
> Southwest Airline is obviously competing with the automobile, there is no doubt about that. There are other factors permitting it to be cheaper than those named here, not only the ticketing and baggaging and what have you, the terminal costs, these people proceed to get a ticket and get on the plane. You don't need a vast terminal. They are not sitting around waiting for a flight 5 hours from now. The bar at Love Field is a little table about like this with a few bottles of whiskey sitting over in the corner. All they have is a cafe, a restaurant, that really is for the people who work there, not for the passengers who are coming there. It is purely a service-oriented activity, and maybe evidence to the contrary, nobody

[75] Hearings at p. 1250 (prepared statement of M. Lamar Muse, president, Southwest Airlines). It should be noted that Southwest has been able to operate its Dallas-Forth Worth flights from Love Field; its competitors have agreed to use an airport that is arguably less convenient. However, Southwest has no such advantage on its San Antonio-Houston flights, and there too traffic increased.

[76] Hearings at p. 1253 (letter to the subcommittee from M. Lamar Muse, president, Southwest Airlines, May 7, 1975.)

[77] Hearings at p. 1259 (letter to the subcommittee from Paul Seligson, counsel, Southwest Airlines, May 9, 1975.)

[78] CAB response to subcommittee questionnaire, question 12.

[79] Pacific is now part of Hughes Air West, a local-service carrier.

[80] This particular example is atypical because of the large number of passengers attracted from San Francisco airport nearby. Yet if 80 percent of the increase is accounted for by such passengers, the lower fare still attracted enough new passengers to provide increased frequency of service.

[81] CAB response to subcommittee questionnaire, question 12.

is holding any gun to anybody's head, making them use that service. They are using it because it is a cheap, efficient, and economic service.[81a]

As previously mentioned, it is difficult to say to what extent lower fares will attract new passengers who would not otherwise have flown. In the case of the San Jose–Los Angeles, for example, undoubtedly much of the traffic increase is accounted for by passengers who simply switched from San Francisco to San Jose airports. The CAB and the regulated carriers do not believe that fare cuts will so dramatically increase the amount of air travel demanded elsewhere in the country.[82] Of course, actual experience with competition and fare reduction—in California and Texas—casts doubt on these predictions. Yet even if they are correct, for reasons discussed at p. 55, below the subcommittee believes that the public would prefer low fares even if accompanied by some reduction in the frequency of service.

c. Freedom To Compete Seems Responsible for Lower Fares in California and Texas

At the subcommittee's request, Professor William A. Jordan of York University prepared an extensive comparison of three instances in which entry into the industry and price competition were allowed with instances in which they were not.[83] His study shows that in California, entry was easy and airlines were free to offer lower prices for 20 years. During that time, approximately 18 independent, small airlines entered the industry, and approximately sixteen of these left it through merger or bankruptcy. Those airlines that remained provided reliable service at low prices. The obvious implication is that existing competition and the threat of new entry led different carriers to try different types of service at different prices; those airlines that could efficiently provide travelers with the service and price they wanted were successful; and travelers obtained the fuller-plane, low-fare service they desire.[84] After a study of California's experience, the Board's staff concluded in 1965, "PSA's always low fares have attracted traffic from competitors, have induced fare reductions by them, have brought down average fares, and have apparently expanded total traffic far above what it otherwise might be." [85]

This conclusion is corroborated by experience elsewhere. Professor Jordan found, for example, that when competition for Military Air Transport Service was freely allowed, prices were far lower. When a new competitor, free to lower its price, entered the Texas market, prices fell. On the other hand, air service on comparable routes in Canada, where regulation is similar to that administered by the CAB, is provided at similarly high prices.

[81a] Hearings at p. 527.

[82] The CAB uses an estimate of demand elasticity of –0.7. See pp. 178 ff., infra.

[83] Professor Jordan's book, *Airline Regulation in America* (1970), explores the California experience in great detail. The book grew out of Professor Jordan's experience working for CAB-regulated airlines.

[84] Witnesses who hesitate to generalize from the California experience do not disagree with this conclusion. Rather, they argue that service to smaller communities in California was less adequate before state public utility commission regulation began in 1965. Indeed, PSA serves Fresno, Long Beach, Stockton, Sacramento and San Jose now; it did not prior to 1965. And, a new airline, Air California has begun service to several other communities. Of course small towns were served prior to 1965 as well. Air California's entry would seem to flow from more competition not more regulation and, CAB carriers consistently used the PUC's processes to oppose the extension of PSA's low-fare service to small towns. The problem of whether additional competition means less service to small towns is discussed in detail at pp. 56–75, infra. See, statement of James Mitchell of Continental Airlines, and supplementary statement of William A. Jordan.

[85] Bureau of Economics staff study of California Air Service (1965), pp. 11, 21 contained in the CAB response to the subcommittee questionnaire, question 12.

Competition between Southwest Airlines and the CAB carriers in Texas provides some empirical confirmation of the description at page 39 of how competition can force lower prices.[86] Price competition by a new entrant, Southwest, was first matched by the existing CAB lines. Then, when the CAB carriers—Braniff and Texas International—decided that they could not profitably meet Southwest's competition—a fact that may in part have resulted from Braniff's use of a different airfield rather than any inability to compete in price [87]—they withdrew from the low-price market, offering their original, higher-priced service. Southwest has carved out a market for itself that did not exist before; it remains in that market earning excellent profits with its low-priced service. It also remains under the threat of renewed entry and price competition by its competitors—Braniff and Texas International—should it choose to raise its price significantly. (For a chronology, see page 50, table 4.)

A less direct indication that competition in airline service works [88] is provided by commuter air service, where prices and entry are unregulated.[89] Most of the commuter carriers publish and adhere to schedules, publish and adhere to fares, interline passengers and luggage with the certificated carriers, and, when necessary, a few use sophisticated reservation system networks. They provide reliable and efficient service. Through competition one carrier has sometimes supplanted another with the result that service improved markedly.[90] In the commuter market, there has been a high rate of entry; there has also been considerable turnover of carriers in some individual markets; but there is a relatively low rate of failure among the established carriers. In some instances, when a carrier withdrew from a market, a new carrier swiftly entered and service proceeded without significant interruptions.[91]

A final indication that the carriers behave in fact the way competitive theory suggests is provided in experience on routes where the CAB has allowed an unusual amount of competition or where it has set prices that are inordinately low. Carriers on those routes have not continued to provide surplus amounts of service nor have they gone bankrupt. In the Hawaiian market, where the CAB allowed five carriers to enter in 1969, after a period of excess capacity and initial loss, the airlines cut back scheduled service, increasing average load factors to 58.9 percent, and some of those serving the route now find it profitable. While charging fares about 25 percent lower than on comparable routes elsewhere, United Air Lines, for example, now

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[86] See p. 39, supra.

[87] The CAB Bureau of Accounts and Statistics writes that Braniff's withdrawal from service was brought about by "pressure from business and community interests" which forced it to move its operations from the more-convenient Love Field to "the less-convenient Dallas-Forth Worth Airport" [comments on staff draft report, July 8, 1975, p. 3.] The Bureau believes that Braniff could have continued economically to match SWA's prices. This fact—if correct—would add support to the claim that SWA's new entry forced down fares which might be permanently maintained.

[88] An additional related piece of confirming evidence was provided by Professor Thomas Gale Moore, of Stanford University, who has studied extensively regulation of trucking in Europe. The arguments for and against competition are very similar in the trucking and airline industries. West Germany has the strictest regulation in Europe, controlling both rates and capacity. Great Britain has no economic regulation whatsoever as it deregulated trucking some years ago. In 1975 trucking *profits* were as high, or higher, in Britain as in West Germany; but trucking *rates* in West Germany were 53 percent higher in 1973 than in Great Britain. The reason, presumably, is that a high regulated rate simply attracts and encourages extra capacity, pushing costs to the level of price. Hearings at p. 75.

[89] See Eads, *The Local Service Airline Experiment* (1972).

[90] See brief of the Bureau of Operating Rights to the Administrative Law Judge, CAB docket 22973, Jan. 19, 1973, p. 93-98. As a result of competition among commuter carriers, for example, the Boston to Bar Harbor market was provided with year-round service, 5 daily nonstop trips in the summer and 3 in the winter. The scheduled carrier, Delta would offer summer service only and no more than a single round trip at that. (See Initial Decision of Administrative Law Judge, CAB docket 22973 (July 9, 1973) at p. 42.

[91] For example, when Executive Airlines withdrew from the New York–Pittsfield market, it was replaced by another commuter within 3 days. See, initial decision of Administrative Law Judge, CAB docket 22973 (July 9, 1973).

TABLE 4.—1-WAY COACH PRICES[1] FOR DALLAS-HOUSTON AND DALLAS-SAN ANTONIO SERVICE SOUTHWEST AIRLINES, BRANIFF AIRWAYS AND TEXAS INTERNATIONAL AIRLINES, JUNE 1971 TO DECEMBER 1974

	1-way coach price[1]							
	DAL-HOU (222 miles)				DAL-SAT (253 miles)			
	Day		Night		Day		Night	
Effective date	SW	BN/TT	SW	BN/TT	SW	BN	SW	BN
1971-								
June 1		$27				$28		
June 18	$20	[3] 20			$20	[3] 20		
1972-								
May (not available)	[4] 20	[3] 20	[3] $10		20	[3] 20	[4] $10	
July 9	[4] 26	[3] 20	[3] 10		[4] 26	[3] 20	[4] 10	
July 17 to 21	[5] 26	26	[3] 10	[6] $10	[5] 26	26	[4] 10	
Oct. 30	[7] 26-13	[8] 27	[9] 13		[7] 26-13	[8] 28	[9] 13	
1973-								
Jan. 20	[7] 26-13	[8] 27	[9] 13		13	[8] 28	[9] 13	
Feb. 1	13	[10] 27-13	[9] 13		13	[8] 28	[9] 13	
Apr. 2	[7] 26-13	[11] 27-20	[9] 13		13	[8] 28	[9] 13	
May (not available)	[7] 26-13	[12] 27-13	[9] 13	[13] 13	13	[8] 28	[9] 13	
June (not available)	[7] 26-13	[12] 27-13	[9] 13	[13] 13	13	[10] 28-13	[9] 13	
Sept. 24	[7] 26-13	[10] 27-13	[9] 13	[13] 13	13	[10] 28-13	[9] 13	
Dec. 1	[14] 28-15	[17] 28-15	[9] 15	[18] 14.99	13	[19] 29-15	[9] 13	
1974-								
Apr. 16	[14] 28-15	[20] 30-15	[9] 15	[18] 14.99	13	[21] 31-15	[9] 13	
Aug. 1	[14] 28-15	30-15	[9] 15	[18] 14.99	15	[21] 31-15	[9] 13	
Oct. 1	[22] 25-15	30	[23] 15		[22] 25-15	31	[23] 15	
Nov. 15	[22] 25-15	31	[23] 15		[22] 25-15	32	[23] 15	

[1] Jet coach economy 1st-class fare plus 8 percent Federal transportation tax.
[2] This and the subsequent prices in this column to Oct. 30, 1972, were available to intrastate passengers only. Interstate passengers continued to pay the price specified above. Effective Oct. 30, the highest price listed in each entry applied to interstate as well as intrastate passengers.
[3] Applicable to 1 northbound and 1 southbound flight departing after 9 p.m. on weekdays and Sundays.
[4] Applicable to 1 northbound flight departing after 9 p.m. on Fridays and 1 southbound flight departing after 9 p.m. on weekdays and Sundays.
[5] $50 round-trip price. $225 Commuter Club card introduced providing unlimited transportation for a 30-day period.
[6] Available to intrastate passengers on a daily Braniff weekday flight departing Dallas at 7:30 p.m. and returning from Hobby Airport in Houston at 9 p.m.
[7] $26 on weekday flights prior to 8 p.m. $13 on Saturday and Sunday flights with a $25 round-trip price.
[8] 1st reported in the Nov. 15, 1972 edition of the OAG. The CAB authorized a 2.7 percent across-the-board fare increase effective Sept. 5, 1972, and this price was probably a result of that action. Texas International advises that it adopted this price for intrastate passengers on Jan. 11, 1973.
[9] Applicable to flights departing on or after 8 p.m.
[10] Braniff: to from Houston Intercontinental Airport $27, to/from Hobby Airport $13 with $25 round-trip price. Texas International: to/from Houston Intercontinental $13 effective Feb. 20, 1973.
[11] Braniff: $27. Texas International: $20.
[12] Braniff: weekdays $27, Saturday-Sunday to/from Houston Intercontinental $27, Saturday-Sunday to/from Hobby Airport $13. Texas International: $20.
[13] Available to intrastate passengers on one Braniff flight departing Hobby Airport at 9 p.m. daily.
[14] $28 for intrastate passengers utilizing approximately 10 daily flights. $13 for intrastate passengers utilizing another 5 or so designated flights.
[15] Braniff: weekdays $27, Saturday-Sunday to/from Houston Intercontinental $27, Saturday-Sunday to/from Hobby Airport $13. Texas International: weekdays $27, Saturday-Sunday through Sept. 30, $20; effective Oct. 1, $27 on all days.
[16] $28 on weekday flights prior to 8 p.m. $15 on Saturday and Sunday flights.
[17] Braniff: weekdays $28, Saturday-Sunday to/from Houston Intercontinental $28, Saturday-Sunday to/from Hobby Airport $14.99. Texas International: $28.
[18] Available to intrastate passengers on Braniff flights departing on or after 7 p.m. to/from Hobby Airport.
[19] $29 for intrastate passengers utilizing approximately 10 daily flights. $14.99 for intrastate passengers utilizing another 5 or so designated flights. Effective Jan. 13, 1974: $29 for all flights to/from Dallas-Fort Worth Regional Airport, $15 for all flights to/from Love Field (see table 4).
[20] Braniff: weekdays $30, Saturday-Sunday to/from Houston Intercontinental $30, Saturday-Sunday to/from Hobby Airport $14.99. Texas International: $30.
[21] $31 for all flights to/from Dallas-Fort Worth Regional Airport, $15 for approximately 3 daily flights to/from Dallas Love Field. Braniff terminated all service at Love Field effective Sept. 1, 1974.
[22] $25 on weekday flights prior to 7 p.m. $15 on Saturday and Sunday flights.
[23] Applicable to flights departing on or after 7 p.m.

Sources: Southwest Airlines, "Annual Report" (1971, 1972 and 1973). Also "Quarterly Report" (3 mo. ended Mar. 31 1972–74, June 30, 1972–73, and Sept. 30, 1971–73). Texas International Airlines, letter from V. R. Shelley (July 16, 1974). "Official Airline Guide" (North American Edition, Apr. 15, June 1, Sept. 14, Oct. 15, Nov. 1, and Dec. 1, 1972, Apr. 1, May 15, June 15, July 15, and Nov. 15, 1973; Jan. 15, Feb. 1, May 1, Aug. 1, Oct. 15, and Dec. 1, 1974). "Aviation Week and Space Technology" 43 (Apr. 30, 1973), and 37 (June 4, 1973). The Houston Post 5 A (Jan. 31, 1973).

finds its Chicago–Hawaii and San Francisco–Hawaii routes among its most profitable. Similarly, on many San Juan–East Coast routes, where fares are about 16 percent lower than on comparable mainland routes, the carriers, when faced with losses, have cut back on scheduling, raising load factors to 68 percent.[92]

d. The CAB's Reaction

Since low-fare flights in California and Texas have been very popular for some time, one might have expected the CAB to try to learn from those examples. Instead, the Board has corroborated the views of those who claim regulators treat price competition with suspicion and fear. In 1965 the Board's staff prepared an extensive study on California service. It concluded that vigorous competition, spurred on by PSA's consistently lower fares, led both to lower prices and by expanding total traffic also improved service.[93]

Despite the obvious suggestion that price competition might have a role to play elsewhere in the United States as well, the Board never followed up its study. It told the subcommittee that:

> As is the case in respect to many staff studies, no further studies or other actions were taken in connection with that staff research report. We do not know why the Board or its staff did not undertake further studies or related action.[94]

Instead, the Board has shown hostility toward the intrastate airlines. Although the California airlines have requested the CAB to allow them to sell their passengers "interline" tickets (tickets on connecting flights outside California), the Board has refused to do so. Nor will it require the CAB airlines to sell PSA's or Air California's cheap tickets to passengers outside of California. Thus, a Boston passenger, wishing to fly from Boston to San Francisco and then to Los Angeles, cannot buy a low-cost PSA or Air California ticket between San Francisco and Los Angeles through one of the CAB carriers. Rather, he must buy a ticket for that portion of the trip from one of the CAB airlines and pay $7 more for the identical flight.[95] A Massachusetts resident should not have to pay more for a flight between San Francisco and Los Angeles than a California resident; if necessary, United, TWA, and American Airlines should be required to sell Massachusetts and other interstate passengers PSA's low-cost intrastate California tickets. There is simply no reasonable argument to the contrary.

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[92] See exhibit TWA–R–7, CAB docket 22908.

[93] CAB, Bureau of Accounts and Statistics, "Traffic, Fares, and Competition: Los Angeles–San Francisco Air Travel Corridor," at pp. 11, 21 (1965).

[94] CAB response to subcommittee questionnaire, question 12.

[95] See, for example, the following exchange between Chairman Kennedy and Robert W. Clifford, president, Air California:

> Senator KENNEDY. If you want to fly from Boston to San Francisco to Orange County, could you buy a ticket in Boston to do that?
>
> Mr. CLIFFORD. No, sir, you cannot. We would like to interline baggage and interline passengers for truly intrastate operations on a break of your trip, if you will, if you were planning on spending 1½ days in San Francisco, and traveling to Orange County. We have applied for such services and are not able to offer that.
>
> Senator KENNEDY. Why have you not been able to get it?
>
> Mr. CLIFFORD. Well, there is the question of inter- versus intra-state carriage, common carriage of customers.
>
> Senator KENNEDY. Well, what happened to the applications?
>
> Mr. CLIFFORD. The application was denied.
>
> Senator KENNEDY. By whom?
>
> Mr. CLIFFORD. By the Civil Aeronautics Board.

While PSA charges $18.75 to fly from Los Angeles to San Francisco, the CAB carriers charge $26 for that same trip. Moreover, if the CAB applied its regular fare formula to that route, the CAB carriers would have to charge $41, see p. 111, infra, Hearings at p. 448.

Moreover, there are those who read the threat of hostile action against the intrastate carriers between the lines of recent Board policy statements. On November 7, 1974, Vice Chairman O'Melia said:

"From an operational point of view, perhaps the most troublesome aspect of the (intrastate) problem is that a number of States are authorizing large aircraft for intrastate operations usually at fare levels well below those found reasonable by the Board for a similar interstate operation. These large aircraft intrastate operations * * * compete head-to-head with certificated interstate carriers and may substantially impair their economic posture."

The Vice Chairman went on to say that intrastate carriers might be subject to Federal jurisdiction even if their flights operated only within one State.[96] Of course, if the Board asserted jurisdiction over the intrastate carriers, the Board's fare formula would apply and carriers might have to raise their fares.[97] The present $18.75 San Francisco–Los Angeles fare would under the formula jump to $41. Thus, to see the low-fare intrastate carriers as a problem emphasizes the Board's set of priorities, that is, the Board's concern with protecting existing CAB carriers rather than encouraging low prices.

e. A Caveat

Both the Board and many of the airlines have pointed to certain features of California and Texas experience that call for caution in using that experience as a basis for recommending changes in national regulatory policy.

First, it has been pointed out that airline service in both California and Texas is regulated, but by State agencies, not the CAB. The relevance of this fact is limited, however, for two reasons: (a) For 20 years prior to 1965, competition within California was open, with prices and entry virtually unregulated. State regulation of entry did not begin to take effect until 1967–69. The present low-fare level seems to reflect that period of open competition not the present system of State regulation; comparison of 1965 intrastate, and interstate, fares would have revealed greater, not lesser, differences.[98] (b) Texas State regulators have followed roughly that system of liberal entry and price regulation that the subcommittee recommends and contrasts with the present system of CAB regulation. Southwest Airlines' experience is taken as some evidence of the effect of certifying a new airline with freedom to compete in price.

Second, it has been pointed out that during the 20 years of open competition within California, 14 of 16 carriers withdrew from the market, some of them because of bankruptcy.[99] On the other hand, individual bankruptcies did not significantly interrupt airline service, which continued to be provided by other carriers. The subcommittee has noted that protection of individual carriers from bankruptcy is an important feature of CAB regulation (see pp. 98–99, infra).

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[96] CAB press release, "Remarks by Hon. Richard J. O'Melia," Member, Civil Aeronautics Board, fall regional ALTA convention, West Virginia, Nov. 7, 1974.

[97] See pp. 109–112, infra. PSA does not want to raise its fares to the formula level, yet under the Board's rules, it would (arguably) be required to do so.

[98] See note 46, supra.

[99] Only 1 of the 14 airlines that failed was in fact a going concern driven from the industry by competition (Jordan, *Airline Regulation in America: Effects and Imperfections*, pp. 17–24 (1970)). Of the 14 airlines, 10 never became established as they lasted only 15 months or less. Two of the remaining were in fact one company that underwent a paper reorganization. The successor, California Coastal Airlines, voluntarily gave up the scheduled passenger business to concentrate on charter operations. The remaining two airlines ceased operations because of adverse rulings by the Federal Aviation Administration.

And it is aware that an increasingly competitive environment may increase financial risks for some individual carriers. Yet, the benefits increased competition will bring the traveler would seem easily to outweigh any increase in financial risk. And, in any event, the subcommittee has tailored its recommendations with an eye toward keeping an increase in risk to a minimum.

Third, it has been argued that California and Texas service does not include a significant amount of service to small towns and much of the service to smaller communities which is provided has come about as a result of State regulation. It has been countered that some smalltown service was provided under open competition in California prior to 1965, that more is provided now, and that State regulation is not responsible for its provision.[100] The subcommittee notes that such service is provided in Texas and California, but that network of service to smaller communities is far less extensive than the vast network of nationwide service. For this reason, it does not rely upon California or Texas experience to draw conclusions about the possible adverse effect of increased reliance upon competition, but, rather, it investigates that question directly in a nationwide context at pp. 63–73, infra.

Fourth, it has been noted that Southwest's success may be partly due to the fact that it offers service from Dallas out of Love Field, a more convenient airport, while its competitors fly from Dallas–Fort Worth, a less convenient airport. The significance of this fact is limited, however, for Southwest also offers other profitable service that does not operate out of Love Field. Moreover, Southwest believes that its success, in large part, stems from its low-fare policy. In any event, the Love Field question is only tangentially relevant to the basic point: that the certification of a new, low-fare competitor led to the development of low-fare service over the route that it serves.[101]

Fifth, it should be kept in mind that many of the factors, such as weather and congestion, cited on pp. 42–45 above, may contribute to some extent to lower fares in California. The point is that those factors, even when taken together, do not explain *very much* of the fare differences.

In sum, though California and Texas experience offers significant, but imperfect, evidence as to the effects of increased reliance upon competition, of course, perfect empirical confirmation about the effects of a new policy is never available. Thus, the subcommittee, while not relying wholly upon this experience, considers it as one important piece of evidence in a lengthy chain of fact and argument, which, when taken as a whole, has led the subcommittee to its conclusions and recommendations.[102]

2. Other evidence.

It can be shown that elsewhere in the country—outside of Texas and California—that: (1) fares can be reduced significantly by flying planes that are fuller (pp. 45–55), and (2) most travelers would prefer

[100] On this point and the bankruptcy question, the reader is urged to study the colloquy between Professor Jordan and James Mitchell of Continental Airlines. Hearings at p. 587.

[101] See p. 49, supra.

[102] In light of past experience, there is far greater risk that the Board and the industry will understate the significance of the California and Texas experience than that they will rely too heavily upon it.

such fuller-plane, lower-fare service even if it meant fewer scheduled flights (pp. 55–56). If increased competition increases the likelihood of firms offering consumers what they want, these two factors suggest that increased competition would bring about lower fares.

Lockheed Aviation Corp. has submitted figures to the subcommittee showing the cost of flying its L–1011 on flights of 500, 1,200, and 2,500 miles, with varying numbers of seats and with varying load factors (see table 5, below). Lockheed's calculations show that a transcontinental flight could be operated profitably at a fare of less than $90 one way, provided the seating configuration was all-coach and the plane was 70 percent full. The current regular coach one-way fare is $175—a fare that is in large part explained by the fact that only 256, rather than 330, seats are carried in planes which fly 40 to 50 percent full. Of course, the fuller that planes fly on the average, the more often they will fly full at peak periods. And the carriers argue that it is impractical to fly planes 70 percent full on average throughout an entire nationwide route system. Yet, no one could deny that on many routes, a 70 percent average load factor is not too high. Such load factors were attained regularly in California before 1965 [103] and the CAB staff does not consider load factor to be a sign that additional service on a route is required until it reaches a level of 75 percent.[104] In any event, to fly the planes 60 percent, rather than 70 percent, full would produce fares only a few dollars higher.

TABLE 5.—ESTIMATED TOTAL OPERATING COST AT VARIOUS SEATING CONFIGURATIONS, LOAD FACTORS AND MILEAGES: LOCKHEED AIRCRAFT [1]

L–1011–1 DOMESTIC PASSENGER SERVICE (NO CARGO)

[In 1970 dollars]

Flight distance (in statute miles)	Load factor (in percent)	Number of passengers	TOC/airport miles	TOC/passenger miles	Staff calculation of possible 1-way fare [2]	Regulated CAB-formula fare (in dollars) [2]
256 available seats (20/80 mixed class)						
500	50	128	11.48	8.97	49.30	[3] 52.80
	60	154	12.25	7.95	43.72	[4] 52.80
	70	179	13.05	7.29	40.09	[3] 52.80
1,200	50	128	7.59	5.93	78.27	[4] 85.13
	60	154	8.04	5.22	68.90	[4] 85.13
	70	179	8.49	4.74	62.56	[4] 85.13
2,500	50	128	6.16	4.81	132.27	[5] 156.60
	60	154	6.50	4.22	116.05	[5] 156.60
	70	179	6.83	3.82	105.05	[5] 156.60
330 available seats (all-economy)						
500	50	165	12.50	7.58	41.87	[3] 52.80
	60	198	13.48	6.81	37.45	[3] 52.80
	70	231	14.43	6.25	34.37	[3] 52.80
1,200	50	165	8.20	4.97	65.60	[4] 85.13
	60	198	8.74	4.41	58.21	[4] 85.13
	70	231	9.29	4.02	53.06	[4] 85.13
2,500	50	165	6.62	4.01	110.27	[5] 156.60
	60	198	7.02	3.55	97.62	[5] 156.60
	70	231	7.42	3.21	88.27	[5] 156.60

[1] Fares have been calculated by adding onto a fare calculated on the basis of total operating costs an additional 15 percent to represent such nonoperating items as return on investment.

[2] Indicates calculations performed by the subcommittee. All other figures and calculations performed by Lockheed Aircraft Corp.

[3] CAB Order 74-12-109 (13.85 plus (500 × 7.79 cents per mile)).

[4] Id. (13.85 plus (1,200 × 5.94 cents per mile)).

[5] Id. (13.85 plus (2,500 × 5.71 cents per mile)).

[103] Hearings at p. 1315.

[104] BOR study at p. 166.

Lockheed's figures are corroborated by separate studies submitted to the subcommittee by Boeing Aviation Corp. and by Prof. Theodore Keeler of the University of California at Berkeley. From cost estimates supplied by the Boeing Co., the subcommittee has calculated that with an all-coach seating configuration and a 70-percent load factor, transcontinental service in a B–747 could be provided at a one-way fare of roughly $74–$93, and medium-range 500-mile flights could be flown in 727–200's for $30–$37.

Professor Keeler based his study on the actual 1974 costs of the CAB carriers for operating their existing fleets. He concludes that with PSA-type seating and only a 60-percent load factor, transcontinental fares might be reduced about 30 percent and short-haul fares could be reduced even more.[105] All three sets of calculations—Lockheed's, Boeing's, and Keeler's—are roughly consistent with current charter fares. The March 1975 one-way fare for a charter flight from Boston to San Francisco (2,704 miles), for example, was $91.[106]

Of course, if planes were fuller, fewer flights might be needed to accommodate travelers and service might become less frequent. Is the lower fare likely to be worth the added inconvenience of having to wait longer for a flight? Most travelers would answer, "yes." For one thing, there may be little, or no, extra wait. Lower fares generated enough new traffic to *increase* the number of flights in California. For another thing, any reasonable estimate of the value of time to passengers show that service now is far too frequent.[107]

The Air Transport Association, for example, assumes that the average traveler values his time at about $10 per hour.[108]

Professor Merton Peck of Yale University concluded that:

> If waiting time is valued at $10 per hour, the added cost [from too much capacity] in 1969 was $456 million annually * * * airlines were flying the right amount of flights [only] for the $60,000 per year man [whose time is presumably more valuable]. Everyone else was being offered too many flights and too high fares. Everyone else would prefer lower fares and would be happy to put up with fewer flights.[109]

Finally, the simple fact is that when travelers have been offered the choice of fuller planes and lower fares, they have chosen it. In Europe, for example, where charter flights are far less restricted (though regular fares are higher than in the U.S.), charters carry nearly 12 million passengers annually. By contrast, charter traffic between the United States and Europe (the most active U.S. charter market) generates 2½ million passengers annually.

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[105] See statement of Prof. Theodore Keeler. Hearings at p. 1300.

[106] See testimony of the National Air Carrier Association, Feb. 25, 1975. Hearings at p. 1260.

[107] See generally, Douglas and Miller, supra note 36, which goes into the matter in detail.

[108] The ATA's estimate was based upon a study prepared for it by Data Resources, Inc. See Hearings at p. 124, n. 12. There is an excellent discussion of the many experiments done on the value of time, and the considerable consensus attained in Harrison & Quarmby, "The Value of Time in Transport Planning: A Review." It is a paper presented to the 6th roundtable of The Economic Research Center of the European Conference of Ministers of Transport, Paris, November 1969.

[109] Professor Peck based his conclusion on a study prepared by Michael Pustay. The study must make assumptions about the extent to which fuller planes will force less service. On those assumptions, the optimal number of flights between Chicago and Los Angeles in 1969 would have been 20 per day, 73 percent full, at a $50 fare; the actual number was 30, 49 percent full at a fare of $106. Of course, these figures depend upon highly simplified assumptions about how travelers feel about "time versus fare." In practice, this tradeoff depends very much upon the type of route. Businessmen flying a short trip for example, may try to fit several appointments into a day; a wait of an extra hour between flights may be highly inconvenient. The businessman is likely to have more flexibility, however, in the case of a transcontinental trip, for which plans are more often made well in advance and less complete choice of flights may make less difference. Hearings at p. 74.

TABLE 6.—ESTIMATED TOTAL OPERATING COST AT VARIOUS SEATING CONFIGURATIONS, LOAD FACTORS AND MILEAGES: BOEING AIRCRAFT

BOEING 747–100

Flight distance and load factor	386 available seats (mixed) 9-abreast (economy)			433 available seats (mixed) 10-abreast (economy)				500 available seats (all economy)			
	Number passengers	TOC (amount in millions)	TOC (cents per passenger mile)	Number passengers	TOC (amount in millions)	TOC (cents per passenger mile)	Regulated CAB-formula fare [1]	Number passengers	TOC (amount in millions)	TOC (cents per passenger mile)	Staff calculation of possible 1-way fare [1]
500:											
50 percent	193.0	14.75	7.6	216.5	15.49	7.2	52.80	250	16.54	6.7	36.85
60 percent	231.6	15.96	6.9	259.8	16.84	6.5	52.80	300	17.71	5.9	32.45
70 percent	270.2	17.17	6.4	303.1	18.20	6.0	52.80	350	19.67	5.6	30.80
1200:											
50 percent	193.0	9.68	5.0	216.5	10.07	4.7	85.13	250	10.64	4.3	56.76
60 percent	231.6	10.33	4.5	259.8	10.80	4.2	85.13	300	11.47	3.8	50.16
70 percent	270.2	10.98	4.1	303.1	11.52	3.8	85.13	350	12.31	3.5	46.20
2500:											
50 percent	193.0	7.80	4.0	216.5	8.04	3.5	156.60	250	8.40	3.4	93.50
60 percent	231.6	8.20	3.5	259.8	8.49	3.3	156.60	300	8.91	3.0	82.50
70 percent	270.2	8.60	3.2	303.1	8.94	3.0	156.60	350	9.54	2.7	74.25

BOEING 727–200

Flight distance and load factor	134 available seats (mixed)			155 available seats (all economy)			
	Number passengers	TOC (Amount in millions)	TOC (cents per passenger miles)	Number passengers	TOC (amount in millions)	TOC (cents per passenger mile)	Staff calculation of possible 1-way fare
500:							
50 percent	67.0	5.48	8.2	77.5	5.81	7.5	41.25
60 percent	80.4	5.90	7.3	93.0	6.29	6.8	37.40
70 percent	93.8	6.32	6.7	108.5	6.78	6.3	34.65

1200:							
50 percent	67.0	3.84	5.7	77.5	4.07	5.2	68.64
60 percent	80.4	4.06	5.1	93.0	4.28	4.6	60.72
70 percent	93.8	4.29	4.6	108.5	4.53	4.2	55.44
2500:							
50 percent	67.0	3.09	4.6	77.5	3.11	4.0	110.00
60 percent	80.4	3.22	4.0	93.0	3.27	3.5	96.25
70 percent	93.8	3.37	3.6	108.5	3.43	3.2	88.00

[1] See Lockheed chart, p. 42.
[2] Calculated by subcommittee staff on an assumption of all-economy flights, adding an extra 15 percent to cover nonoperating costs plus profit.

BOEING 727-100

Flight distance and load factor	103 available seats (mixed)			117 available seats (all economy)		
	Number passengers	TOC (amount in millions)	TOC (cents per passenger miles)	Number passengers	TOC (amount in millions)	TOC (cents per passenger miles)
Note:						
500:						
50 percent	51.5	4.71	9.2	58.5	4.93	8.4
60 percent	61.8	5.03	8.2	70.2	5.30	7.6
70 percent	72.1	5.36	7.4	81.9	5.66	6.9
1,200:						
50 percent	51.5	3.39	6.6	58.5	3.50	6.0
60 percent	61.8	3.57	5.8	70.2	3.71	5.3
70 percent	72.1	3.73	5.2	81.9	3.90	4.8
2,500:						
50 percent	51.5	2.77	5.4	58.5	2.82	4.8
60 percent	61.8	2.86	4.6	70.2	2.95	4.2
70 percent	72.1	2.97	4.1	81.9	3.07	3.8

BOEING 737-200

Flight distance and load factor	102 available seats (mixed)			115 available seats (all economy)		
	Number passengers	TOC (amount in millions)	TOC (cents per passenger miles)	Number passengers	TOC (amount in millions)	TOC (cents per passenger miles)
500:						
50 percent	51.0	4.00	7.8	57.5	4.20	7.3
60 percent	61.2	4.32	7.1	69.0	4.56	6.6
70 percent	71.4	4.63	6.5	80.5	4.92	6.1
1,200:						
50 percent	51.0	2.76	5.4	57.5	2.86	5.0
60 percent	61.2	2.92	4.8	69.0	3.05	4.4
70 percent	71.4	3.09	4.3	80.5	3.24	4.0

Source: The Boeing Co.

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TABLE 7.—COMPARISON OF ESTIMATED REGULATED AND UNREGULATED FARES

City-pair	Estimated unregulated fare (1)	Lowest regular for coach or economy fare (2)	Percent markup from (1) to (3)	Lowest regularly scheduled jet discount fare (4)	Percent markup from (1) to (4)
Atlanta–New York	44.30	64.80	46.3	51.85	17.0
Boston–Chicago	49.50	71.30	44.0	54.63	10.4
Boston–New York	17.20	23.15	34.8	19.44	13.0
Boston–Philadelphia	21.90	33.33	52.2	24.07	9.9
Boston–Washington	26.70	39.81	49.1	29.63	11.0
Buffalo–New York	22.30	33.33	49.5	24.07	7.9
Chicago–Cleveland	23.10	35.19	52.3	35.19	52.3
Chicago–Detroit	20.20	27.78	37.5	22.22	9.5
Chicago–Los Angeles	89.50	116.67	30.4	103.70	12.2
Chicago–Miami	64.90	94.44	45.5	75.93	17.0
Chicago–Minneapolis	23.80	37.04	55.6	35.19	47.9
Chicago–New York	43.60	62.96	44.4	47.22	8.3
Chicago–Philadelphia	41.50	59.26	42.8	59.26	42.8
Chicago–St. Louis	19.70	28.20	45.8	22.22	12.8
Chicago–San Francisco	95.20	129.63	36.8	103.70	6.6
Chicago–Washington	37.20	53.70	44.4	53.70	44.4
Cleveland–New York	28.20	41.67	47.8	41.67	47.8
Dallas–Houston	18.70	[1] 23.15	23.8	13.89	−25.7
Detroit–New York	31.40	47.22	50.3	36.60	16.6
Las Vegas–Los Angeles	18.30	27.78	51.8	27.78	51.8
Los Angeles–New York	126.70	173.15	36.7	137.96	8.9
Los Angeles–San Francisco	20.80	18.06	−13.2	13.43	−35.5
Los Angeles–Seattle	53.30	70.37	32.0	70.37	32.0
Miami–New York	62.00	87.04	40.3	65.28	5.3
New York–Pittsburgh	24.00	36.11	50.4	26.39	10.0
New York–Rochester	20.20	28.70	42.2	21.76	12.7
New York–San Francisco	133.20	173.15	30.0	137.96	2.4
New York–Syracuse	18.00	25.93	44.5	19.44	13.7
New York–Washington	19.60	26.85	36.8	18.98	−3.2
San Francisco–Seattle	38.80	53.70	38.4	53.70	38.4
Los Angeles–San Diego	9.30	9.73	4.6	6.35	−30.3

[1] Fare is for winter 1975.

Source: Fares come from Official Airline Guide 1 (Oct. 1, 1974). California intrastate off-peak fares come from PSA flight schedule, Oct. 18, 1974. This table was compiled by Theodore Keeler. See Hearings at p. 1300. For derivation of other figures, see text.

In sum, evidence from Texas and California, from Lockheed and Boeing, and from expert studies shows conclusively that low-fare, fuller-plane air travel can be provided throughout the United States. It strongly suggests that the public wants such service. It also tends to confirm the argument, made by most of the Board's critics, that increased reliance upon competition is likely to lead to the provision of such service.

C. THE ARGUMENTS AGAINST INCREASED RELIANCE UPON COMPETITION

The CAB and most of the regulated carriers advanced a number of often interrelated arguments against various proposals that would substitute increased reliance upon competition for classical price, profit, and entry regulation. The arguments embodied in those claims will be separated and discussed individually.

1. Predatory pricing.

Some airline representatives argued that open competition might lead some airlines to cut their prices below costs, thereby driving other carriers from these markets.[110] Once the cutrate airline obtains a

[110] See Hearings at p. 585 (prepared statement of Harvey Wexler, senior vice president, international and governmental affairs, Continental Airlines).

monopoly in a particular market, the argument goes, it would then raise its fares to excessive levels and leave the public far worse off than it was before the price competition began.

The predicted behavior is known as predatory pricing. In reality, very few cases of predatory pricing have been found in competitively structured industries [111] such as airlines. For a firm to have an incentive to price predatorily, two preconditions must be met: (1) The predator must be so much stronger than its rivals that, after cutting prices below variable cost, it will outlast them; and (2) Reentry into the predator's market must be so difficult that the predator can later hold its prices well above cost and recoup its prior losses before other firms, attracted by high profits, enter the market. Unless a firm is reasonably certain in advance that both these conditions will be obtained, it is irrational to engage in predatory pricing.

With unanimity, experts told the subcommittee that these conditions do not exist in the airline industry.[112]

To the contrary, predatory pricing is more likely to occur in a regulated than in an openly competitive environment. The predator needs assurance that rivals will not reenter its market once prices rise; the obstacles to entry raised by regulators—the difficulty of obtaining route certification—can provide that assurance. Thus, the most likely instance of predatory behavior cited to the subcommittee consisted of predatory conduct by two regulated carriers—Braniff and Texas International—aimed at forcing an unregulated carrier—Southwest—from the Texas intrastate market. (Both Braniff and Texas International are under indictment; these observations are thus tentative and unproved.)[113]

Often healthy price competition is confused with predatory pricing. The former may involve lower cost carriers charging lower prices that take business from higher cost carriers; the latter involves short-term prices well below cost set with the objective of destroying competition and later recouping through prices well above cost.

At the subcommittee's hearings last November the supplemental airlines were accused of setting North Atlantic charter fares below cost, and it was claimed that a minimum rate floor was needed to stop predatory pricing. Cost studies prepared by the Department of Transportation and other evidence revealed, however, that the charter floor sought by Pan American, TWA, and the other scheduled carriers would have led to prices well above the supplementals' cost of service. For reasons set out in detail in the subcommittee's staff report, there was no evidence that anything more than healthy price competition had occurred and, therefore, there was no need to set a minimum rate floor to avoid predatory pricing.[114]

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[111] And, some have claimed that predatory pricing does not occur in noncompetitively structured industries either. See McGee, "Predatory Price Cutting: The Standard Oil (N.J.) Case," 1 J. Law and Economics, 137 (1958).

[112] See Hearings at p. 51 (prepared statement of Thomas E. Kauper, Assistant Attorney General, Antitrust Division, Department of Justice); p. 458 (testimony of William A. Jordan, professor of managerial economics, York University); p. 1203 (prepared statement of John W. Snow, Deputy Assistant Secretary for Policy, Plans, and International Affairs, Department of Transportation). See generally, Areeda and Turner' "Pricing and Related Actions under section 2 of the Sherman Act," 78 Harvard Law Review 697 (1975).

[113] Hearings at p. 1190. For another example see Hamilton and Kawahara, "Predatory Nonprice Competition: The Case of Hawaii Interisland Air Transport," 7 Antitrust L. and Eco. Rev. 83 (1974). See generally, Douglas and Miller, *Economic Regulation of Domestic Air Transport: Theory and Policy*, pp. 39–60 129–33 (1974).

[114] Subcommittee on Administrative Practice and Procedure, Senate Committee on the Judiciary, "Procedures Relating to Minimum Charter Air Fares," staff report (1974).

2. Wasteful or destructive competition.

The airlines made the related argument that more open competition would prove destructive or wasteful. In essence, the argument states that competition would force the airlines to charge prices that covered only variable, but not fixed, costs. In simple terms, an airline president might decide, "As long as my fares cover the cost of making these particular flights plus a dollar, I'll fly them and make the dollar. I'll worry about paying off the mortgage on the office tomorrow." It is imagined that this sort of thinking would characterize at least one airline on each route. The result is that competition would force all airlines to meet this variable cost price on every route; no airline would be able to cover its fixed costs, and all would lose money.

As stated, this argument is implausible, for in many industries, fierce competition coexists with prices high enough to cover fixed costs. Hardware stores, grocery stores, and department stores, for example, may occasionally be tempted to sell a particular item at a price that covers only variable cost without contributing to overhead. Yet, despite competition, each store will price its different goods so as to recover its overhead from some set of its many sales. Each store knows that the only alternative is bankruptcy; the airlines understand this as well.

A more sophisticated version of the argument, however, claims that the cyclical nature of the airline industry is responsible for making price competition in the airline industry destructive or wasteful: When demand for air travel is low, airlines with excess capacity would compete for dwindling traffic by lowering prices to variable costs. Eventually, failure to cover fixed costs would lead them to ground, lease, or sell aircraft, suspend operations at some terminals, and lay off employees. When demand improved, the airlines would seek to increase production, but the costs of doing so—reopening terminals, ungrounding aircraft, rehiring employees—would be wasteful. Thus, the argument runs, rather than going through these cycles of wastefully closing down and opening up productive capacity, it is better to stop price competition through regulation; in this way, the industry as a whole will receive a more steady income in the downswing and will be able to keep its plant in operation until times improve.[113]

The subcommittee finds this argument unconvincing for several reasons.

(a) Under present law, competition of this sort is not foreclosed; it is simply channeled into service competition instead of price competition. The incentives that might drive an airline to lower fares to marginal levels are exactly the same incentives that would lead an airline to add one more flight or one more stewardess even though the addition would generate only enough revenue to pay the cost of the extra flight or extra stewardess without contributing to fixed costs.

Thus, in the late sixties the airlines, relying upon Government studies and their own projections, bought far too many airplanes. The result was significant overcapacity; airlines began to compete, by scheduling more and more flights; and some scheduled to the point

[113] For discussion of both these arguments, see, Hearings at p. 1715 (prepared statement of Randall Malin, vice president, marketing planning, American Airlines; p. 2155 (prepared statement of Melvin A. Brenner, vice president, marketing planning, TWA); pp. 91-92 (testimony of Alfred E. Kahn, chairman, New York State Public Service Commission).

where the incremental revenues from an additional flight just covered the flight's incremental costs.[116]

As a result, load factors fell on transcontinental routes to the point where planes were 37 to 38 percent full, and their revenues contributed virtually nothing to company overhead.

The most interesting fact about this experience with intensive competition in a period of economic downswing is that it has not led to the destruction of the industry. There has been no widespread bankruptcy.[117] Return on investment, on average, at the bottom of the cycle was very low, but still positive.[118] Some airlines withdrew a moderate amount of capacity from some routes.[119] In essence, most of the burden of loss from too much investment in aircraft fell on the airline shareholders—precisely what one would expect to occur in any industry during a downswing and what one would hope for in order to discourage overinvestment during an upswing.[120] Moreover, had there been price competition as well as service competition during this period—the last 6 years—airlines are unlikely to have been worse off. The airlines practiced "incremental cost scheduling" on some but not all routes. The same factor which prevented them from practicing it on every route (a commonsense desire for self-preservation) would have worked to prevent incremental cost pricing on every route. Indeed, a leading Wall Street airline analyst has argued strongly that lower prices during this period would have increased airline profitability because of the increased traffic that they would have generated.[121]

Finally, the cost of reopening closed-down capacity (ungrounding airplanes, reacquiring planes leased to others, retraining crews) [122] during the next upswing is not large.

(b) It was argued in the thirties, and before the subcommittee,[123] that regulation was necessary to eliminate wasteful, destructive competition. The subcommittee has reviewed the history of competition in the twenties and thirties with some care; it finds no evidence from that period that, without regulation, "destructive competition" did, or would, take place (see appendix B, below). The industry itself, a leading proponent of regulation in the thirties, was unable to cite any actual instances of destructively competitive practices that had occurred. Colonel Gorrell, for example, the representative of the Air Transport Association, testified in 1938 that regulation was desirable in part because:

> * * * not many people are willing to go into [the airline] business today. . . . [And they will not do so] unless there is some proper protection against fly by night companies whereby such irresponsible companies cannot come along with a

[116] See testimony of Melvin Brenner, *Capacity Reduction Agreements Case*, CAB dkt. 2290S, reprinted in Hearings at p. 2166.

[117] This is not surprising, for firms, when faced with overcapacity and the prospect of low profits or losses, can take many steps short of bankruptcy. They can lease or sell excess airplanes; they can renegotiate the terms of debt obligations; they can cut costs in a variety of ways; and, as a last resort, they can reorganize their financial structure voluntarily.

[118] At the low point of the recent downswing, trunk carrier return on investment was 1.59 percent (1970). See BOR study, appendix B, table 11.

[119] Thus in the early seventies United, American, Continental, and others grounded some capacity and leased or sold other planes. No one argued that the cost of putting grounded airlines back into service was high. See pp. 148–49, infra.

[120] A witness from American Airlines testified in a Board proceeding that without the threat of bankruptcy, it would be difficult, if not impossible, to prevent the carriers from scheduling excessive flights. See testimony of Randall Malin, dkt. 2290S, discussed at p. 149, infra.

[121] See Hearings at p. 2240 (statement of Herbert Moser, of Merrill Lynch, Pierce, Fenner & Smith, Feb. 14, 1975).

[122] And, of course, given the existence of service competition, that cost is likely to be incurred whether or not price competition is encouraged.

[123] See, for example, hearings at p. 117 (prepared statement of George James, Air Transport Association); p. 631 (prepared statement of Andrew M. De Voursney, United Air Lines).

lot of second hand planes and cut prices right out from under legitimate operators. A system which permits such an operation gives no protection for an orderly growth of the business between the points to be served.

Mr. SADOWSKI. Has that been done on very many occasions?

Mr. GORRELL. No, it has been much closer than I would like to talk about. I have been shaking in my boots very recently on this subject. [124]

Thus, Professor Caves, after an exhaustive study of the industry wrote that the notions of destructive competition are "prevailing myths which hold that without the Board's restraining hand, the airlines would collapse in a war of destructive competition." He concludes that charges of such chaos misrepresent the history of the industry and that "nothing in the industry's structure supports this concern." [125]

In any event, conditions in the airline industry in the 1930's were very different from those today. Airlines then were subsidized; a subsidized firm has every incentive to cut its prices well below cost, for, by doing so, it will take business from its rivals, it will increase its size, and it will not lose money—the Government will make up the losses. Today, trunk airlines are not subsidized.[126] Thus, whatever incentive then existed for a firm to cut prices and incur large losses is now lacking.

(c) Even if price fixing were desirable as a way to keep equipment operating during an economic downswing, it would also have the undesirable effect of encouraging overinvestment. It would protect firms from the unprofitable consequences of failing to predict demand accurately, thus resulting in price rises to consumers.

The subcommittee concludes that any waste that increased price competition might bring to the industry is insignificant. It is unlikely to outweigh the wholesome effects of such competition in keeping prices low, investment decisions rational, and reducing the Nation's travel bill by hundreds of millions (or billions) of dollars per year. There is no reason to believe that increased competition would prove either wasteful or destructive.[127]

3. Monopolization.

Some airlines argued that competition would allow the larger carriers to drive the smaller carriers out of business, leaving an industry with only one or two firms; the remaining firms might then raise prices and exploit the consumer. The subcommittee, however, heard virtually no evidence in support of this claim, and considerable evidence suggests the contrary.

The argument seems to reflect a confusion between what might occur on individual route segments and what might occur in the Nation as a whole. A more competitive system might leave one or two airlines serving most, or all, of the market on particular route segment. PSA, for example, accounts for more than half the San Francisco–Los Angeles traffic. Yet, there is no reason to believe that the carrier dom-

[124] Aviation Hearings on H.R. 5234 and H.R. 4652 before the House Committee on Interstate and Foreign Commerce, 75th Cong., 1st sess., at p. 76 (1937) (emphasis added).

[125] Caves, *Air Transport and Its Regulators*, pp. 382–83 (1966).

[126] For the 12 months ending June 1975, the local service carriers received subsidy payments of $59.1 million (CAB, *Quarterly Economic Report—June 1975*).

[127] In fact, Congress has been unwilling to protect industries with a far better reason to fear "wasteful competition" than airlines. Industries with large capital investment where plant is immobile, such as steel or copper, are far more likely to suffer waste from excessive competition in economic downswings than are airlines. Aside from efforts in the 1930's to form "depression cartels" through the National Industrial Recovery Act, Congress has not specifically focused on the "wasteful competition" argument, except in the transportation industries. See 2 Kahn, *The Economics of Regulation*, p. 19 (1970).

inating one route will be the same carrier that dominates other routes elsewhere in the region or in the Nation. The facts that airlines can achieve efficient size while relatively small and that entry is not overwhelmingly expensive suggests the contrary.[128] As long as other routes are dominated by other carriers, a single carrier dominating one route will hesitate to raise its prices significantly, for fear that another carrier will enter its market. Rather, the carrier will set what Acting Secretary Barnum referred to as a threshold price—a price that may be above cost but that remains low enough to make the market unattractive to potential competitors.[129]

The height of this threshold price depends upon how easy it is for other carriers to enter. And a study prepared by Lockheed Aircraft suggests that at present it would be fairly easy for several new carriers to enter every major route segment in the country. Lockheed found that both of the end points of every major route segment are now served by at least two or three airlines that do not fly between them. That is to say, for example, that in addition to the several airlines now flying between Boston and Chicago, at least two other airlines serve both Boston and Chicago but do not fly between them. The cost for such an airline of entering the Boston–Chicago market is very small; thus, a carrier currently dominating the Boston–Chicago market would hesitate to raise its prices above costs. While this form of competition might be less effective if a single carrier were to dominate the entire country, there is simply no reason to believe that would happen.[130]

4. Reduced service to small communities: no more cross subsidy.

The major argument advanced by the airlines against increased reliance upon competition is that increased competition would mean less service to small- and medium-sized communities. One part of that argument states that such service depends upon pure cross subsidy;[131] it is claimed that airlines use revenues earned on profitable, dense, long- and medium-haul routes to subsidize service on short, less dense unprofitable routes. If competition on the more profitable routes destroys the extra profit, there will be no revenues left to subsidize unprofitable service, and service to smaller communities will be discontinued.

[128] Professor Jordan estimated that without any economic regulation, there would be 200 to 400 airlines in the United States. See Hearings at p. 453. No one suggested there could be fewer than five or six major airlines. Entry is complicated to discuss because entry costs vary considerably depending upon whether one focuses on airlines currently flying nearby routes, airlines flying elsewhere, or firms totally outside the industry. Entry from outside is expensive, but since planes can be leased, even the cost of outside entry is not prohibitive. In any event, entry barriers are not high enough to allow one or two firms to charge exorbitant prices. The fact that airlines flying in one place can more easily enter another market simply strengthens this conclusion.

[129] See Hearings at p. 10 (testimony of Department of Transportation Acting Secretary Barnum).

[130] If it did, the remaining airline would still have to fear entry by firms outside the industry. Since startup costs are greater for such firms, however, threshold prices would be higher.

[131] The term "cross subsidy" is dangerous because it means so many different things to different people. This report will divide what those in the industry tend to call "cross subsidy" into two kinds of situations. The first of these involves situations in which the revenues generated by a particular service are less than the incremental cost of providing such service. Such service must be supported by revenues generated elsewhere; and, firms will seek to end such service if free to do so. This situation is here referred to as "pure cross subsidy," and it is discussed at pp. 63–68. A second situation involves service that generates revenue in excess of its incremental cost but which makes only a small contribution to overhead or profit. Firms will not necessarily seek to discontinue such service if free to do so. This second situation raises a different set of problems than "pure cross subsidy," and it is discussed at pp. 69–70. Although those in the industry often refer to the second situation as one of "cross subsidy," others often reserve their use of the term for the first situation. This latter usage, not the industry's, is followed here.

It should also be noted that there could be different sorts of "pure cross subsidy." Long-haul flights might subsidize below cost short-haul flights; summer flights might subsidize below cost winter flights; morning or evening flights might subsidize below cost midday flights, etc. The report focuses on the claim that flights to smaller communities are being (purely) cross-subsidized by (often longer) flights on more popular routes, for that is one basic part of the claim that increased reliance upon competition means significantly reduced service to smaller communities.

The subcommittee concludes that the "pure cross subsidy" argument is not a significant reason for maintaining classical regulation. The executive branch—the Council of Economic Advisers, the Department of Transportation, the Council on Wage and Price Stability, and the Department of Justice—as well as independent experts claimed that pure cross subsidy simply does not exist to any significant extent in the case of trunkline service and their claim is correct. Moreover, if cross subsidy did exist, it would not be desirable.

Their reasons for believing that cross subsidy now does not exist on trunkline service include the following: First, because carriers on long haul, or other profitable, routes engage in extensive scheduling competition, there is ordinarily little, if any, extra revenue to use to subsidize short-haul routes. In other words, scheduling of more, emptier planes tends to eat up additional profits on long-haul routes, while on short-haul, less dense, unprofitable routes carriers tend to cut scheduling, raising load factors to the point where the routes become barely profitable. Thus, for example, in 1972, when the average load factor for all markets was about 52 percent, the load factor for long-haul markets was 48 percent. Transcontinental load-factors were 39 percent in 1971.[132] And TWA's load factors in 1968 were about 47 percent on its routes of over 2,100 miles and 55 percent on its routes under 500 miles—a relation which has been constant over time.[133] The Board itself has stated that where fares exceed costs "rather than providing subsidization of short-haul services * * * [they] merely subsidize wasteful competitive practices. * * * Only if the domestic air transportation system consisted of a single monopoly carrier," could cross subsidy be expected to succeed.[134]

Second, cross subsidy would in any event be limited by the fact that lucrative long-haul, dense market routes are not served by the same carriers as many of the short routes. TWA's domestic system, for example, has an average segment length of 800 miles; Allegheny's average segment length is 200 miles. TWA's extra profits—if any—could not easily filter through to Allegheny.[135]

Third, for the past few years the Board has allowed airlines to discontinue service on routes on which they are losing money. For the most part the Board has abandoned the cross subsidization theory as a basis for setting rates or providing service. While some carriers may have chosen to continue to provide service on losing routes for political, or other noneconomic, reasons, one would expect to find that service on many such routes has already been discontinued.

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[132] Before capacity reduction agreements took effect.

[133] See BOR study at page 83; exhibit TWA–R–3, CAB docket 22908. Fixed costs per unit decrease as the length of the flight increases. Thus, longer flights at equivalent fares per mile would tend to be more profitable. The figures quoted below show that at least *some* of their extra profit is eaten up through the scheduling of additional service. The figures alone do not show whether *all* of that profit is eaten up though such is very much the implication of carrier arguments in the *Capacity Reduction Agreements Case.*

[134] CAB Order 74-382, pp. 71–2 (Mar. 18, 1974) (emphasis added).

[135] See testimony of George Eads, Council on Wage and Price Stability, Hearings at p. 1216. Both these points are well summarized by the CAB itself in its Order 74-382 at p. 71. The Board states "since not all carriers have an equal mix of long-haul and short-haul routes, those carriers having predominantly short-haul routes, and relatively few medium- and long-haul routes. They do not have an opportunity to gain the excess profits from long-haul routes necessary to cross subsidize short-haul routes. Under the cross subsidization theory predominantly long-haul carriers are allowed to charge above cost fares in longer markets in order to cross subsidize short-haul markets which to a great extent they do not possess. Accordingly the long-haul carrier will either receive excessive earnings or will operate with the low average efficiency of substandard load factor." (This conclusion should be modified, however, to the extent that the Board's policy, set forth in phase 4 of the DPFI, requires carriers to divide interline fares in proportion to their comparative costs. This policy could, in some instances, result in Allegheny receiving more than its scheduled fares for a TWA-Allegheny joint trip.)

Fourth, service to small communities—service on short-haul routes of low traffic density—is often far more profitable than accounting cost figures show. Such routes, for example, may be feeder routes generating traffic that continues on over a longer, more profitable route segment, or such routes may be used by carriers to position their aircraft. Carriers prefer to fly such routes despite the fact that allocating cost and revenue on a basis of route miles may show losses. Since feeder routes generate traffic that goes on to pay a longer distance fare as well, to discontinue the routes would deprive the carrier of revenue on the longer haul. Thus, for example, United Air Lines will continue to fly between Cedar Rapids and Chicago whether or not it is free to abandon that route because the flight generates traffic that goes on to fly between Chicago, and, say, New York. Taking the generated revenue into account, the Cedar Rapids–Chicago route is profitable. It is, then, not surprising to find that carriers in California and Texas—unregulated by the Board—serve small- and medium-sized, as well as large, communities. PSA provides service to Fresno and Stockton as well as San Francisco and Los Angeles. And Southwest Airlines has recently started service between Dallas and Harlingen, a medium-sized community in Texas.[136]

If there is little cross subsidy in existence, there is little need to evaluate the claim that cross subsidy is inferior to a direct subsidy as a means for maintaining service to smaller communities (the CAB now grants $66 million per year in direct subsidies). Nonetheless, it is worth noting that critics have urged that theoretically cross subsidy is inequitable. Assuming that its purpose is to stimulate commerce by helping businessmen to travel quickly between small towns and larger cities, why should, say, a vacationer, traveling cross country, pay the bill? "There is no reason why a grandmother flying from New York to Los Angeles should be the one to subsidize well-off businessmen traveling between small towns." [137] It is also argued that cross subsidy is inefficient. Because higher fares will discourage travel and will to some extent lead to excess service, transcontinental fares might have to rise quite high (by several dollars) to generate one dollar's extra profit that could be used to subsidize service to small towns.[138]

Finally, cross subsidy is politically invisible. Congress would itself have to determine the amount and the direction of direct subsidies; it makes no such determination in the case of cross subsidy. Thus there is never a direct political responsibility for the decision to take money from the long-distance air traveler and use it to subsidize travelers on shorter hauls.

Even if cross subsidy occurs and the air service to smaller communities that it allows is felt desirable, such service might still be provided in the absence of any subsidy. Commuter carriers currently serve 409 airports [140] in cities with a median population of 38,000. Such cities generate a median number of passengers of 14 per day.[141] Most

[136] Intrastate carriers also provide service, for example, between Ontario, California, and San Francisco, Sacramento, and San Diego.

[137] Caves, *Air Transport and Its Regulators: An Industry Study*, p. 411 (1962).

[138] In fact, if the theoretical arguments previously presented are correct, there is virtually no way, given the competitiveness of transcontinental routes, that additional revenue can be generated.

[140] National Air Transport Association "Air Tran News," April 1975, p. 16.

[141] CAB, Bureau of Operating Rights, "Commuter Air Traffic Statistics—year ended June 30, 1975" at table 3 (derived by dividing "total passengers" by "total markets" times 365 days per year—regardless of actual days of service).

smaller towns currently served by trunk carriers fit within this category and thus presumably would receive commuter service even if abandoned by trunklines.[142]

The subcommittee made a substantial effort to obtain empirical information that would tend to show the extent to which increased competition might lead to the abandonment of service to small communities. The carriers and the Air Transport Association were asked to submit lists of those routes they believed would likely be abandoned if regulatory control of entry and prices were significantly liberalized.[143] United Air Lines, in response, told the subcommittee that 58[144] of the 327 city-pairs that it serves are unprofitable in the sense that revenues generated (in 1974) "failed to cover incremental costs." [145] United agreed, however, that the fact that United's accounting system shows these routes as unprofitable does not mean that United would abandon them. Many of these 58 routes are actually profitable because they are flown to position aircraft or they are feeder routes, generating traffic that flies elsewhere.[146] In fact, United estimates that 4 of the 58 are flown to position aircraft, 17 are flown because of their traffic generating ability. Thus United would consider abandoning only 37 as unprofitable.[147] From these 37, there should be subtracted an additional 8 routes, each of which is shorter than 60 miles in length; for it is inconceivable that trunkline service is needed on routes of 24, 30, or 57 miles (such segments were probably included in United's "37" because they form part of a large loss route that United would abandon).

There remain 29 route segments in United's system that might be viewed as the beneficiaries of cross subsidy. Those 29 segments average 155 miles in length; together they accounted for 130 million revenue passenger miles, or about one-half of 1 percent of United's total domestic revenue passenger miles. United lost $5.5 million serving them.

It may be reasonable to assume that United's experiences are typical, for United is the Nation's largest domestic carrier accounting for approximately 22 percent of total airline revenues. And United's profits are just above average for the industry. Using United's figures on this rough-and-ready basis suggests that the trunk airlines might abandon service over approximately 130 segments, accounting for about one-half of 1 percent of total domestic air service were they free

[142] See Eads, Hearings at p. 1217. Moreover, commuter service is sometimes superior to trunk service. Commuter carriers, for example, provided five daily round trips between Bar Harbor and Boston at a time when the scheduled airline, Delta, wished to offer only one such trip.

[143] The ATA and the carriers were asked to assume no change in existing *direct* subsidy.

[144] United noted that in a total of 147 markets, revenues did not cover fully allocated costs. Those markets (89) where revenues exceed variable costs but are less than fully allocated costs raise very different questions, which are considered at pp. 69–71, *infra*.

[145] Letter to Stephen Breyer from William Nesbit, United Air Lines, April 29, 1975, Hearings at p. 636. An earlier letter to Senator Kennedy from Andrew W. De Voursney of United Air Lines, Feb. 28, 1975, describes these routes as failing to "produce sufficient revenue to cover their direct variable cash costs." Hearings at p. 635.

[146] An earlier study by United, indicated that 75 route segments did not cover variable costs. See letter to Senator Kennedy from Andrew W. De Voursney, Feb. 28, 1975, Hearings at p. 635. Discussions with the subcommittee staff indicated that of the 75, 40 were profitable because of their traffic generating ability or their use for aircraft positioning. Of the remaining 35, United had already suspended service to 13, leaving 22 as candidates for abandonment. United lost—on its accounting figures—$4 million serving those 22. United had the opportunity to reexamine its loss routes more closely in March and April and revised its figures in its letter of April 29. The revised figures are used in the text.

[147] United also states that it would consider deleting service on routes where revenues cover incremental costs but fail to contribute an average amount to overhead. Such routes are not properly discussed in this subsection, however, for they are not being cross subsidized. Given United's existing system, it is more profitable for United to serve such routes than to cancel service, for extra revenues generated exceed extra costs incurred. As long as United covers its overhead *somewhere* in its system, it will continue service. Whether increased competition makes it less likely that United can recover its overhead is considered in the next subsection.

to do so. If the trunklines abandoned these routes, commuter carriers or local service carriers might provide them with service. Route segments still unserved—if any—could be directly subsidized and made profitable at low cost (to subsidize all of them would cost less than $25 million per year).

The Air Transport Association has also provided the subcommittee with a study of the extent to which airlines would curtail service under "deregulation." The study used a model prepared by Lockheed Aviation Corp. The Lockheed model accurately simulates airline behavior under present regulatory conditions. But the ATA incorrectly used this model to simulate conditions without regulation. The model, which assumes fixed prices, was operated on the assumption that without regulation the airlines would be able to cut flights and service to the point where the airline system as a whole maximized profits. In fact, such behavior would be possible in the absence of regulation only if the airline system were run by a single monopolist or a perfect cartel; it would not be possible in a competitive industry.[148] Using this model, the ATA argues that, without regulation, the industry (presumably operated by a monopolist or cartel), in maximizing profits by curtailing service, would end service on 373 nonstop route segments now served by trunk carriers where, according to the ATA, incremental revenues are less than incremental costs. It suggests that without regulation those routes would be abandoned.

Surprisingly, it might be argued that the ATA study supports the conclusions drawn from United's submission. Like United, the ATA arrived at its figure of 372 without taking into account: (a) the fact that, like United's original list of 75 loss routes, a number of routes have already been abandoned; [149] (b) the fact that a number of so-called loss routes are actually profitable because they feed traffic onto other flights or segments, which, when taken together, generate sufficient revenues to cover or exceed costs; (c) the fact that a number of nonstop routes are used to position aircraft and will be flown empty or full, with regulation or without; (d) the fact that a number of segments are less than 60 miles long and, with no need for trunk service themselves, simply tag along as part of other, longer loss routes. If it is assumed that these factors have roughly the same importance in the ATA's study as they did in United's, the ATA indicates that without additional direct subsidy about 148 cross-subsidized route segments might no longer receive nonstop trunk service.

The subcommittee is reluctant to draw any conclusions, favorable or unfavorable, from the ATA study, however, for careful scrutiny of that study by the Council of Economic Advisers, the Council on Wage and Price Stability and several independent experts confirms that it is fatally flawed. Since the study is based on the probable future behavior of what could only be a monopolist or a cartel operating in a world of fixed prices [150]—a monopolist that would fly its planes 86.7-percent full on average and earn $2 billion in profit each year, it says little about what would happen in the real world. In fact, the real world without regulation would not be inhabited by an

[148] The ATA tries to overcome this defect by reworking the model assuming different levels of fixed fares, i.e., fares of 10 and 20 percent less than the present level. This change does not cure the basic problem: that the ATA uses the model to determine what routes would be cut on the assumption that without regulation, any firms within the airline system could maximize profits by cutting as much service as it wants without fear that other firms would then take away business from it—a condition that could not occur as long as the industry is competitive.

[149] See note 146, supra.

[150] See note 148, supra and accompanying text.

airline monopolist or a cartel. It would be a highly competitive world with flexible prices, where planes could not fly 86.7-percent full on average, and carriers could not earn $2 billion profit per year.[151] For this reason, and others,[152] the Council on Wage and Price Stability felt that the ATA study "provides no useful information about the likely effects of deregulation"; [153] one expert suggests that the model is being "misused by subjecting it to a task for which it was not designed;" [154] another believes that "the weaknesses of the study are so glaring that the study simply cannot support the case the ATA wants to make;" [155] and the Council of Economic Advisers concludes that the "interpretation the ATA has placed on the simulation excessively overstates the extent of route abandonments that might take place under deregulation." [156] The subcommittee believes that the United Air Lines submission provides a far more reliable, accurate empirical effort to measure the extent of cross-subsidy—and the extent to which its elimination would lead to route abandonments—than does the ATA model.[157]

In the subcommittee's view, the theoretical, and direct practical, evidence together suggest that some cross subsidy may exist within the present airline system, but that it is small in amount. The trunk carriers probably fly no more than 100 to 150 routes—most of them short and infrequently traveled—that they would like to abandon. If the trunk carriers abandoned nonstop service over such route segments, most would still be served by local-service carriers, commuters, or even by trunk carrier's providing one-stop or multistop service. If necessary, nonstop service on these route segments might be maintained with a direct subsidy of well under $25 million. Costs of that magnitude are low compared with the possible savings of hundreds of millions or billions of dollars that a more competitive system might bring. It is nearly inconceivable that service to any community would be totally eliminated.

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[151] The ATA's study is based upon the assumptions that prices throughout the domestic system are fixed and that service is cut to the point where the industry earns maximum (enormous) profits. Such a condition could come about only with price regulation, and then only if one monopoly airline flies all flights. Such an airline would maximize profits by severely curtailing the level of service. One by one, such an airline would cut out flights (as the ATA uses the model to do) if in fact the system as a whole is more profitable without the flight than with it. Naturally since a monopolist can increase load factor and profits significantly between, say, New York and San Francisco by cutting the number of flights per day between these two cities, the model shows a rather drastic reduction in the level of service provided. If the model were used to simulate competitive conditions (as the ATA purports to do, but did not) instead of being used to stimulate monopoly conditions (and all policy changes proposed would increase not decrease, competition) it would show that airlines could not cut flights so severely. Any airline drastically cutting service would not increase its profits, but would just divert passengers to its competitors. Such competition would prevent industry profits from being maximized and would lead to the provision of more service at any given fare level. For this reason, too, one cannot determine that airline service over a particular segment will disappear just because the model shows no flights over that segment when the (monopolist) industry maximizes profits. Rather, the fact that under competitive conditions additional flights will be flown between New York and San Francisco, reducing average load factor significantly below the 86.7-percent level shown in the model, means that under competitive conditions airlines will also fly more passengers than the model shows from say, Fresno to San Francisco, for such flights will generate traffic for San Francisco–New York flights. (The ATA's faith in its own study seems to rest upon the fact that the study accurately simulates actual profits, yields, trips, etc., at current 55-percent load factors. This fact in no way mitigates the basic criticism—that in determining what would happen without regulation, the ATA, by assuming the level of flights that maximizes system profits, is assuming away all possible competition.

[152] The ATA study also includes depreciation in its cost figures; airlines will not necessarily include those costs in making scheduling decisions. See Hearings at p. 382.

[153] Hearings at p. 394.

[154] Letter from Andrew Whinston, professor of economics, management, and computer science, School of Industrial Administration, Purdue University, May 9, 1975, Hearings at p. 430.

[155] Letter from Professor Sam Peltzman, School of Business, University of Chicago, May 5, 1975. Professor Peltzman also notes that seven of the routes that the ATA study shows being eliminated under deregulation are in California and Texas where they are currently willingly served by "unregulated" carriers. If the study can reach this conclusion, something is plainly wrong with the study.

[156] Submission from the Council of Economic Advisers, May 1, 1975. Hearings at p. 382. The submission makes an effort to draw some lesson from the model about what might happen under *competitive* conditions; it relaxes the assumption of maximum industry profits and thereby concludes that, 500 out of 7,300 flights might be curtailed, not several thousand, and that 30 nonstop markets might be abandoned, not 372.

[157] The ATA also states that many flights that are currently receiving direct subsidy might be abandoned under deregulation, since neither the subcommittee nor any witness proposed abandoning direct subsidy, this portion of the ATA's study is irrelevant.

5. Reduced service to small communities: failure to cover overhead—cream skimming.

The airlines argued that service to smaller communities might be reduced for a second reason (sometimes called "cross subsidy").[158] Some routes are highly profitable, generating revenue sufficient not only to cover the airline's *additional* (incremental) costs of serving the individual route, but also contributing revenue toward the carrier's overhead costs (including profit). Other routes are less profitable, generating revenue just barely sufficient to cover the carrier's additional costs in serving the individual route. As long as the carrier covers its overhead costs somehow, it will continue to serve these latter routes (for, as long as they generate revenues even slightly greater than the *additional* (incremental) cost of serving them, it is more profitable for the airline to provide service than not). But, if total system revenues do not cover overhead, the airline will not replace aircraft; it will gradually shrink its system; and some routes will no longer get service. If increased competition is allowed, it is argued, new competitors will serve the more profitable routes, driving down the revenues obtained from those routes (sometimes called "skimming the cream").[159] With less revenues from these profitable routes, it is argued, the trunk carriers will no longer be able to cover all their overheads, they will fail to replace aircraft; they will shrink their systems; and some routes that they now serve will be discontinued.

In the subcommittee's view, this argument does not show that service to small communities is likely to be reduced significantly. First, the fact that revenues on some route segments cover incremental costs, but make less than an average contribution to overhead, shows nothing about what would happen to service on those routes with increased competition. As previously mentioned, at p. 60, supra, firms in many major industries—no matter how competitive—sell some items at prices that cover only variable costs while recovering their fixed costs from sales elsewhere within their system. As long as overhead can be recovered from some set of sales, service will be provided.

Second, increased competition does not mean that firms will necessarily fail to recover overhead. Assume, for example, that United Air Lines obtains revenues higher than its incremental costs on flights from Chicago to Hawaii. Without some such routes United cannot cover its overhead. But, a competitor interested in flying between Chicago and Hawaii will also have overhead; it must generate revenues from somewhere within its own system to pay for its airplanes. There is no particular reason to believe that new entrants on particular routes will, in general in the long run, be able to fly at lower costs than existing efficient carriers. In fact, existing carriers may have a significant advantage. As they are quick to point out, providing a network of connected service is advantageous to travelers. Many travelers want to fly between two cities on a single plane with only one stop in between, or to fly on one airline with conveniently scheduled connections; and they presumably would pay more for this service. The

[158] This use of the term "cross-subsidy" is misleading for there is no "subsidy." Virtually every business recovers disproportionate amounts of overhead from different product lines. See note 13, supra.

[159] "Cream skimming" is also used to describe the argument made at pp. 63–68, infra.

ability to provide it should give the established carrier an advantage over the "cream skimmer" sufficient to capture customers at a fare high enough to provide funds needed for the extra service. Thus, whether increased competition would drive fares so low that existing service will be curtailed is doubtful.[160]

Third, because of present excess capacity, airlines may hesitate to replace airplanes as quickly as in the past, but this is no reason to believe they will cut service to small communities. In fact, more competition may lead to more service to small communities. Suppose, for example, a new entrant drives down prices on United's Chicago–Hawaii route, and, by doing so, it captures most of that market from United. Why would that new entrant not go on to serve, say, Cedar Rapids–Chicago or Lansing–Chicago? Those routes generate traffic that goes on to Hawaii (or elsewhere); and, if it paid United to keep such routes because of their traffic generating ability, why would the same not be true for the new entrant? In fact, if competition on major routes drives the price of service on those routes down, might those routes not become *more* attractive to potential travelers living in small towns nearby? Might not traffic from the small town to the major hub then *increase*, making the feeder route a denser, *more* profitable route? [161]

Similarly, new entrants have often developed service to small towns that previously did not exist. Air California deliberately set out to develop service to Palm Springs, Santa Ana, and Ontario, California. Southwest Airlines has developed service to Harlingen, Texas. The California carriers, prior to 1965,

> did not limit their service to the major markets. Rather, they provided extensive service to eight minor California markets . . . (and they) were the first to provide scheduled service at Inyokern and Lake Tahoe and they were the only carrier group to do so at Brown Field. This shows that CAB type regulation is not a necessary condition for airline service to be provided in low density markets . . . The intrastate carriers were not protected in major markets, yet they provided service in minor markets.[162]

And, of course, local service carriers and commuter carriers provide considerable small-town service. These facts may explain why the Airport Operators Council International representing small, medium-sized and large communities, while opposed to complete free entry, believes that increased competition on major and smaller routes will mean more, not less, service to small and medium-sized towns.[163]

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[160] Moreover, it is impossible to predict where carriers would cut service if, as a result of replacing fewer aircraft, it shrunk its system. Rather, when the time came to retire an unreplaced airplane, the carrier would rework its whole pattern of routes to attain maximum profitability. For that reason, an analysis of which routes now fail to generate revenues sufficient to cover fully allocated costs (as contained in United's letter of Apr. 29, 1975) says little or nothing about whether, or where, a particular carrier might discontinue service. Hearings at p. 636. (And, of course, for reasons set out above, that service in any event may well be supplied by others).

[161] Allegheny Airlines gives a specific example, in its testimony. Of the 47,391 passengers carried over its Pittsburgh–Philadelphia segment in July 1974, 71 percent were local; the remaining 29 percent were through passengers. Allegheny flew at an average load factor of 60 percent. Allegheny states that "a flight serving the Pittsburgh-Philadelphia market may well serve four or five or six other city-pairs. For example, a flight from Providence to Hartford, Philadelphia, Pittsburgh, and Columbus would serve ten individual city-pairs." The ability of the flight to be scheduled, however, frequently is dependent on the load factor critical segment between Philadelphia and Pittsburgh." Allegheny considers this fact to argue against increased competition "on the critical segment between Philadelphia and Pittsburgh," on the theory that such competition, by making that segment less profitable, will inhibit service to the other four or five or six city-pairs. It is difficult to see, however, how this conclusion follows. If a competing line took business away from Allegheny and flew from Philadelphia to Pittsburgh at a lower fare attracting a considerable amount of the business, presumably it would be in the interest of that new line to continue to connect the Philadelphia–Pittsburgh segment with other cities. Those four or five or six connecting cities will still generate traffic that will be profitable, as some of its flies across the Philadelphia-Pittsburgh segment. Indeed, a lower fare between Philadelphia and Pittsburgh may generate additional traffic between, say, Philadelphia and the other four or five or six city-pairs.

[162] Jordan, *Airline Regulation in America*, pp. 131–132. Note that while many of these carriers went out of business, service to smaller towns in California continues.

[163] Hearings at p. 703.

6. Competition will destroy the complex national airline network.

The airlines have argued that increased competition on major trunk routes may destroy the complex integrated network of air service that now serves the United States. For the most part this claim rests upon fear of cream skimming—the fear that new rivals would serve only popular, profitable markets, leaving less popular, less profitable forms of service to wither and die. The argument has a variety of forms, most of which have been discussed previously:

(a) Sometimes the argument's proponents are thinking of the problem of pure cross-subsidy, discussed in subsection 4, above. As pointed out there, however, the amount of cross-subsidized service now being provided is probably small, and the curtailment of pure cross-subsidy does not mean the curtailment of scheduled service.

(b) Sometimes they rest their claim on the problem of covering overhead, discussed in subsection 5 above. As pointed out there, however, there is little reason to think that the need to cover overhead would result in the widespread curtailment of air service.

(c) Sometimes it is simply claimed that increased competition would destroy scheduled service, for not enough passengers would fly on scheduled flights to support them. Little evidence was advanced in support of this contention, however. Those few facts produced that were relevant to the point suggest the contrary: Extensive scheduled service existed in California—at low fares—throughout 20 years of open competition; extensive scheduled service exists in Europe—at high fares—coextensive with a vast system of charter flights; Southwest Airlines—a new competitor—has successfully experimented with offpeak pricing, making offpeak scheduled service more profitable, increasing the amount, the variety, of scheduled service. The evidence—while impressionistic—provides no basis for fearing the destruction of scheduled air service.

(d) Sometimes it is suggested that network service—with interline ticket and baggage arrangements—is simply too complicated to be provided without regulation. The suggestion, however, appears unwarranted, for nothing in the nature of complex network service requires regulation of price. Other industries create and maintain complex service networks without it. Banks, for example, provide elaborate credit card systems, involving central banks, correspondent banks, merchants, and cardholders, requiring the transmission of vast amounts of information over long distances. This complex integrated service is provided without price or profit regulation. If customers are willing to pay for integrated network service, it should be provided without regulation.[164]

A more modest form of the "network" argument is that increased competition would not destroy the network of scheduled service, but it would *change the pattern of service* that the network provides.[164a] In particular, major airlines would concentrate more upon the provision of fuller-plane, lower-fare service between major hubs. Service to smaller towns would be provided to a greater extent by commuter airlines than by local service carriers, and such service would likely connect the small town directly only with the nearest hub rather than providing direct nonstop service to more distant cities.

[164] If they are not willing to pay its price, should it be provided without a clear explanation of just what is being provided (that customers would not pay for) and why it should be provided through the payments of others? The answer to this question is usually put in terms of the need to stimulate commerce through increased service to small towns—a matter discussed in the text immediately following.

[164a] This argument is made clearly and forcefully in the comments of former Deputy Assistant Secretary of State Bertram Rein on the subcommittee staff's draft report.

The first problem with this claim is that the changes it predicts may not occur. Of course, the provision of low-fare service between hubs will undoubtedly act as a magnet tending to attract local service of the form just described. But, certain factors will remain at work tending to preserve local service in roughly its present form. These include: (a) The fact that most local service now provided is profitable on an incremental basis (see pp. 63–68, supra); (b) the fact that insofar as lower fares stimulate more travel, connecting service—even to more distant hubs—will become more profitable (see pp. 69–70, supra); and (c) the fact that a greater tendency to lower fares in direct response to fuller planes may, in turn, generate sufficiently increased long-distance travel from some small towns to warrant as much, or more, nonstop service to more distant communities than is presently available. In light of the uncertainties surrounding the relative importance of these and other factors, no one can say whether present patterns of local service would change as the argument predicts.

A second, more serious, problem with the argument is that its predicted pattern of change may prove desirable, not undesirable. Those who fear a change in the direction of more central hub/feeder-type service argue that such service is less likely than the present pattern to stimulate the commercial growth of smaller communities and that it would increase congestion at major airports. Yet, increased competition would bring with it lower fares on popular routes that may make it easier, on balance, to reach a smaller town from a more distant city. In fact, a lower general fare level together with increased availability of commuter service might *stimulate* the commercial development of smaller towns. And, of course, small-town passengers, like others, would benefit from general fare reductions on more popular routes. The congestion problem—which will not be discussed in depth here [165]—might be relieved to some extent through the additional use of satellite airports which in turn might ease access to many smaller communities. Thus, it is not surprising that those witnesses representing the interests of many smaller communities tended to prefer the risks of significantly liberalized entry and fare policies to maintenance of the status quo.

It must also be kept in mind that the existing pattern of service is by no means ideal. Present route structure, after all, arises out of CAB route certifications awarded carriers at different times for a variety of different reasons, including the desire to maintain a "balance" of revenues and profitability. The result contains many economically irrational conditions that inhibit efficiency, as, for example, when they forbid Pan American to carry San Francisco–New York passengers on its half-empty planes that make the journey anyway on their way to Hawaii. Insofar as increased competition forces consolidation of the route structure—eliminating such inefficiencies—it is highly desirable.

Finally, in speaking of changes in the more complex parts of the existing route network, one is speaking of changes that affect relatively few existing passengers. According to a Boeing study, for example, 85 percent of all passengers are carried between fewer than 900 city-pairs—or 4 percent of the total number of city-pairs now served. The

[165] The congestion problem is an important one yet it is basically caused by the *growth* of air service. As such, it must be faced regardless of the form of regulation.

remaining 22,000 city-pairs account for about 15 percent of all traffic.[166] Moreover, the most complex part of the existing network—the provision of service between city-pairs that will not support nonstop or one-stop service—accounts for 10.9 percent of all travelers. (About 7.6 percent fly between towns where the best level of service is connecting service and 3.3 percent fly between towns where the best level of service is multistop).[167]

In sum, there is no basis for the claim that increased reliance upon competition would destroy the existing network of air service. The argument that the pattern of service may change, while plausible, provides no good reason for maintaining the present classical regulatory system.

7. Safety.

Some carriers have argued that increased competition would lead to lower profits, which, in turn, would lead the airlines to cut costs, and the result would be a tendency to cut corners on safety. While the subcommittee believes that the question of safety is of overwhelming importance, it is convinced that proposals to change the CAB's system of "economic regulation" would have no effect on carrier safety.

Safety is the concern of the Federal Aviation Administration, not the Civil Aeronautics Board.[168] The Federal Aviation Administration sets standards and inspects all airlines, whether or not they are subject to CAB regulation. The matter of CAB regulatory reform has been discussed within the Federal Aviation Administration and with the Secretary of Transportation, who is responsible for that agency. DOT has assured the subcommittee that it "will not permit any diminution in strict enforcement of safety standards." [169] The FAA has pointed out that "whenever an airline is experiencing serious financial problems, * * * surveillance of the airlines' inspections and maintenance practices is increased by our field inspectors." [170] It will continue to do so.

Efforts to measure the relative safety performance of the CAB-certificated route carriers and the supplemental carriers show that the latter, though subject to less economic regulation, are just as safe, or safer, than the former. The safety records of both types of air carriers are good. In 1966 and in 1970 the supplemental carriers had more fatalities per billion passenger miles flown than the CAB-certificated carriers; in nearly every other year they had *fewer* fatalities per billion passenger miles flown.[171] A further empirical study shows that there is no correlation between fatality rates and profits.[172] Thus both the Air Transport Association and the Department of Transportation have agreed that the problem of safety does not argue either for or against regulatory reform.[173]

[166] See "Density, Fares Alter U.S. Market Patterns," *Aviation Week and Space Technology*, p. 119, Oct. 28, 1974.

[167] See BOR study at pp. 68–72. Note that "multistop" refers to service in the same plane with more than one stop.

[168] FAA sections 301–314, 601–703, 49 U.S.C. sec. 1341–1355, 1421–1443 (1970). All functions of the Federal Aviation Administration were placed under the Secretary of Transportation in 1966. Act of Oct. 15, 1966, Pub. L. 89-670, section 6(c), 80 Stat 937, codified at 49 U.S.C. secs. 1655 (c) (1970).

[169] Hearings at p. 693 (letter from John W. Snow, Acting Assistant Secretary for Congressional and Intergovernmental Affairs, U.S. Department of Transportation, to Senator Kennedy, dated Apr. 25, 1975).

[170] Letter from C. A. McKay, Assistant Chief, Air Carrier Division, Flight Standards Service, Federal Aviation Administration, U.S. Department of Transportation, to Senator Kennedy dated Feb. 12, 1975).

[171] Hearings at p. 1289 (letter from Edward Driscoll, president, National Air Carriers Association, to the subcommittee, dated May 6, 1975).

[172] Hearings at p. 65 (prepared statement of Gary L. Seevers, member, Council of Economic Advisers, and James C. Miller III, senior staff economist, CEA).

[173] Hearings at p. 10 (testimony of Acting Secretary John Barnum).

8. Financing new aircraft.

The airlines argue that the increased riskiness that competition would introduce into their business would make it difficult to place firm orders for aircraft; thus aircraft production would decline and the rate of technological advance would slow down.

The subcommittee finds this result unlikely since competition would bring with it other offsetting tendencies. Increased competition may produce a greater market for small airplanes seating 40–50 passengers. Presently CAB rules that limit commuter airlines to planes seating 30 passengers have inhibited the development of this market.[174] Total demand for aircraft may increase, not decrease, if lower fares produce significantly greater demand for air travel, such as has occurred in Texas and California.

Increased riskiness for *individual* firms does not necessarily mean increased risk for the firms' suppliers. Minerals exploration, for example, is a risky business; but supplying exploration equipment is far less risky.

Finally, it is clear that steps of some sort will have to be taken to deal with the problem of airplanes that are flying with too many empty seats and charging prices that are too high. The Civil Aeronautics Board's regulatory approach to the problem has been to encourage airlines to limit the number of scheduled flights. Such an approach, which will be discussed below in section IIIC, can lead to a serious decline in air travel—a decline that is far more likely to diminish demand for new equipment than allowing increased competition into the airline business. In the subcommittee's view a more competitive approach is preferable for consumers, equipment manufacturers, and the airline industry as well.[174a]

9. The need to proceed gradually.

The carriers strongly and reasonably argue that a shift toward a more competitive policy—particularly a more liberal route-award policy—must not take place suddenly. The industry has grown up under regulatory protection. Its managers and other employees understand how to work in that environment and no other. To subject this industry suddenly to the rigors of a full-blown competitive environment is unnecessary and undesirable. Any such change must take place gradually with ample opportunity to learn how to avoid mistakes and to predict behavior in the marketplace within the framework of a new system.

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[174] For example, sales of the DHC-7 (an aircraft which can fly around 50 passengers) may well be limited, or severely inhibited, by the fact that the CAB will not allow commuter lines to fly planes of this sort.

[174a] The airlines have advanced two other arguments against increased reliance upon competition:

(1) Some say it would be unfair to deregulate domestic air transport while leaving international air transport regulated. Since entry into international aviation would still be controlled, the existing international carriers would have a domestic advantage, for the fact that they could carry domestic passengers abroad would make connecting passengers more likely to fly them domestically. Experience suggests, however, that this argument is not a strong one. California may be considered analogous to the unregulated domestic system; and the regulated domestic market, analogous to the international market. The regulated domestic carriers have had no significant advantage in the California market; to the contrary, the California carriers have captured the lion's share of the business. In any event, as the Board moves toward increased reliance upon competition domestically, it will presumably monitor and adjust its international policies in light of domestic experience.

(2) To deregulate, it is claimed, would leave the airlines at the mercy of airport operators, who would impose their own regulation, extracting large fees. It is difficult to believe, however, that airport operators, anxious to maintain service to their communities, would threaten it by extracting unreasonably large charges. Moreover, should this become a problem, the Federal Government retains power to regulate in the area. In fact, competition may lead to greater use of satellite airports (as in California) thereby making it more difficult for major airports to extract high fees and relieving the congesting at some of them. (While it was argued that increased competition might make airport operators hesitate to expand due to uncertainties of service, the Airport Operators Council International itself evidently did not believe this, for it supported liberalization of regulation, though not total deregulation.)

Moreover, the gradual introduction of a liberalized entry policy would provide an opportunity to change direction should initial predictions prove mistaken. The carriers' claim that considerably greater freedom to enter might severely curtail the amount of service provided in some parts of the country seems weak; it has little empirical support. Nonetheless a phased, gradual introduction of more competition would allow for a reassessment of the policy during each step of the process.

Some carriers claim that the sudden introduction of more competition might drive them into bankruptcy. They argue that, were the industry suddenly opened to all wishing to enter, there might be new capacity introduced, despite existing overcapacity. Sudden new entry and additional capacity, combined with freedom to lower rates, they assert, would force fares down and create a disastrous cash crisis.

This argument is unpersuasive. It assumes that the low fares will not generate enough new traffic to keep the airlines profitable—an assumption upon which the California and Texas experience casts doubt. More importantly, it assumes extreme short run irrationality and instability. In the longer run, planes will tend to fill up to the point where higher load factors justify lower fares. The fear of bankruptcy is precisely what will lead carriers to withdraw capacity (or not to order new planes) until existing capacity is fully used.

How long is that likely to be? The most conservative existing estimate of growth in demand for trunkline travel is 4.6 percent per year (see table 8); thus, if present overcapacity is around 15 percent, the problem should disappear in about 3 years. (In fact, since lower fares would increase demand, the overcapacity will disappear still more quickly.) Thus, this argument, at most, suggests a very limited period of additional protection—protection that should be provided by the *gradual* introduction of a more competitive policy.

TABLE 8.—DOMESTIC U.S. AIR TRAVEL FORECASTS

Organization	Forecast period	Market definition	Average annual percent growth
United Air Lines	1974–80	Trunk scheduled RPM	4.6
		Charter RPM	25.8
		Scheduled plus charter RPM	6.1
Air Transport Association	1974–80	Trunk plus regional RPM:	
		Scheduled	6.7
		Non-scheduled	14.7
		Total	6.9
FAA (as of September 1974)	[1] 1974–80	Trunk, regional and intra-Hawaii/Alaska scheduled RPM.	8.1
Stanford Research Institute	1973–80	Scheduled RPM's	7.2
Lockheed	1974–80	do	6.4

[1] Fiscal years.

Source: United Air Lines, May 1, 1975.

10. Conclusions.

There exists an undoubted problem of serious dimensions: It is clearly both technically and economically possible to provide the type of airline service desired by most passengers at considerably lower fares. This objective might be reached in a number of different ways.

The major changes in policy proposed by most of the critics of the Civil Aeronautics Board is to substitute increased reliance upon competition for the Board's classical price, profit, and entry regulation. The theory advanced by these critics is logically sound. It has empirical confirmation in practical experience. And the general objections to increased competition raised by the airlines and the Board are not strong. Nonetheless, competition undoubtedly brings with it added risk to individual companies; it undoubtedly would change the existing pattern of air service, and it is impossible to foresee precisely what pattern of air service would emerge. It undoubtedly would mean a major change from the method of doing business that the airlines have become used to over the past 37 years.

Under these circumstances, one must ask whether the present system of classical price, profit, and entry regulation is adequate or whether it is flawed to the point where the trauma of major change is warranted. This report will now consider the existing system, as it has been practiced in the past few years. It will conclude that that system is seriously defective, and that those defects are so deeply embedded in the structure of classical regulation (as applied to a basically competitive industry such as airlines), that a major change of direction, rather than minor tinkering, is necessary.

III. PRESENT BOARD REGULATION

Federal economic regulation of domestic airlines is carried out through the exercise of three principal powers delegated to the CAB by the Civil Aeronautics Act of 1938 (reenacted without significant change in the Federal Aviation Act of 1958 ("FAA")). These three powers are: *i.*) the authority to grant or deny "certificates of public convenience and necessity" allowing firms to offer air service on individual routes—often called the entry power; *ii.*) the authority to suspend or determine air fares; and *iii.*) the authority to approve or disapprove interairline agreements, thereby immunizing them from the antitrust laws. The legality, fairness, and effectiveness of the CAB's procedures in discharging each of these principal powers are discussed in this part of the report.

The FAA also grants the CAB several secondary powers including the authority to enforce the FAA and CAB regulations, to approve or disapprove mergers, to grant or withhold subsidy, to formulate regulations regarding such important industry matters as depreciation, baggage liability, tariff quotation, and discrimination. CAB, of course, retains authority to allocate its administrative resources among these different tasks. The major complaints against the CAB's use of these secondary powers in the last 5 years have been directed toward alleged favoritism of the large carriers and a lack of concern with the consumer. A fourth section of this part of the report will consider some of these charges.

It should be emphasized again that the CAB has no responsibility for the regulation of airports or airline safety, which are subject to the authority of the Federal Aviation Administration.

The reader should also note that the subcommittee has been able to look at only some, not all of the Board's work activities in each of these areas, and its conclusions are, therefore, impressionistic. Nonetheless, the subcommittee believes that the instances it examined are sufficiently typical to reveal how the Board has been carrying out its regulatory mandate, and to expose major problems and difficulties in its methods of regulation.

A. ROUTE POLICY

1. Introduction: the effect of the Board's route policy.

Carriers cannot fly interstate without a "certificate of public convenience and necessity" issued by the Board. The Federal Aviation Act instructs the Board to issue a certificate if "the applicant is fit, willing and able * * * " and "such transportation is required by the

public convenience and necessity." [175] The statute goes on to requir the Board to set an application for a certificate for a public hearin and to "dispose of such application as speedily as possible." [176]

The various executive departments, consumer groups, and other in dependent experts criticized the Board severely for the manner in whicl it has used this statutory authority to control entry into the aviation industry. The critics claimed that the Board has not allowed new firms into the industry; that in recent years it has not even allowed firms already in the industry to obtain authority to fly on routes served by competitors; and that the Board's major objective has been to maintain industry stability avoiding decisions that would change the relative market shares of the existing carriers. The critics added that a more liberal entry policy, coupled with freedom to set prices as the carriers desire, would produce lower fares, for the threat of new entry would force competitors to keep prices low.

The Board denied that its entry policy has been restrictive. The acting chairman stated that the expansion of competition in an expanding market has been a primary underpinning of the Board's route policy since 1938. He went on to say that "the Board has no policy which precludes the entry of a new carrier." [177] In addition to hearing witnesses, the subcommittee obtained studies of the Board's route policy from the Library of Congress, the General Accounting Office, and Mrs. Lucille Keyes, a well-known expert in the field. The subcommittee also received considerable statistical information from the Board itself.

For the most part this information bears out the critics' claims. First, consider entry into the scheduled air service industry by outside firms.

In response to a subcommittee questionnaire, the CAB acknowledged that between 1950 and 1974 it had received 79 applications by companies who wanted to enter the domestic scheduled airline industry. Not one was granted! The CAB's handling of these applications is summarized as follows:

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[175] Federal Aviation Act sec. 401(d)(1), 72 Stat. 754 as amended by 76 Stat. 143, 82 Stat. 867, 49 U.S.C. sec. 1371:

(d)(1) The Board shall issue a certificate authorizing the whole or any part of the transportation covered by the application, if it finds that the applicant is fit, willing, and able to perform such transportation properly, and to conform to the provisions of this chapter and the rules, regulations, and requirements of the Board hereunder, and that such transportation is required by the public convenience and necessity; otherwise such application shall be denied.

[176] Federal Aviation Act section 401(c), 72 Stat. 754, as amended by 76 Stat. 143, 82 Stat. 867, 49 U.S.C. 1371. In addition the Board can subject certificates to "reasonable terms, conditions and limitations." Act, sec. 401(e)(1). The CAB cannot revoke a certificate unless it finds that the carrier has intentionally failed to comply with the Act or with a Board order (sec. 401(c)). It can order a temporary suspension of service if it finds that the public convenience and necessity so require (sec. 401(e)). It cannot, however, "restrict the right of an air carrier to add to or change schedules" (sec. 401(e)(4)). These sections provide in full:

(c) Upon the filing of any such application, the Board shall give due notice thereof to the public by posting a notice of such application in the office of the secretary of the Board and to such other persons as the Board may by regulation determine. Any interested person may file with the Board a protest or memorandum of opposition to or in support of the issuance of a certificate. Such application shall be set for public hearing, and the Board shall dispose of such application as speedily as possible.

(e)(1) Each certificate issued under this section shall specify the terminal points and intermediate points, if any, between which the air carrier is authorized to engage in air transportation and the service to be rendered; and there shall be attached to the exercise of the privileges granted by the certificate, or amendment thereto, such reasonable terms, conditions, and limitations as the public interest may require.

* * * * * * *

(e)(4) No term, condition, or limitation of a certificate shall restrict the right of an air carrier to add to or change schedules, equipment, accommodations, and facilities for performing the authorized transportation and service as the development of the business and the demands of the public shall require; except that the Board may impose such terms, conditions, or limitations in a certificate for supplemental air transportation when required by subsection (d)(3) of this section.

[177] Hearings at p. 662 (prepared testimony of Acting Chairman O'Melia).

TABLE 9.—CAB'S HANDLING OF APPLICATIONS FOR ENTRY INTO THE DOMESTIC AIRLINE INDUSTRY 1950–74

Granted	0
Denied after hearing	19
Dismissed without hearing	29
Dismissed at applicant's request, usually after extended CAB inaction	21
Dismissed for lack of prosecution or due to dissolution of applicant company	8
Pending or being heard	2
Total	79

Source: Subcommittee questionnaire to the CAB, question 19, printed in the separately bound appendix to the hearings. Although this response by the CAB lis', 94 applications, 25 deal with exclusively foreign air transportation and therefore have been omitted from the discussion in the text as beyond the primary scope of this report.

Since 1960, only 4 of 32 applications have even been granted a hearing, and of these 4, 2 were applications for operating authority for experimental vertical takeoff and landing aircraft.

Second, consider entry into a particular market by firms already offering scheduled service elsewhere. Mrs. Keyes found that out of 1,800 applications for authority to serve the hundred most heavily traveled city-pairs during the past 10 years, only 8 percent were approved.[178] The GAO's study shows that 123 applications were filed to serve major routes between 1964 and 1969. Of these, 14, or 11.4 percent, were granted. Between 1969 and 1974, 49 were filed, and 2 or 4 percent were granted. The remainder were withdrawn, dismissed as stale, dismissed for some other reason, or remained pending at the end of the period.[179] Further, in the past 2 years, not one airline has been granted new authority to serve any major competitive route.

Since 1938 entry into the industry has been limited to (a) the entry of today's eight supplemental carriers, which provide charter service, and which descend from a group of nonscheduled carriers allowed into the industry at the behest of Congress after World War II; (b) the 19 local service carriers, which were admitted into the industry just after World War II, and which compete to only a limited extent with the trunk carriers; and (c) commuter carriers which operate small airplanes over short routes.

In sum, if we focus upon the trunk carriers, which account for more than 90 percent of all industry revenue and traffic, Mrs. Keyes' conclusion is well supported: "Entry into the industry has been effectively blocked." [180]

Moreover, the market shares of the major existing firms have remained remarkably stable (see table 10). In 1938 the four major carriers—United, American, Eastern, and TWA—accounted for approximately 82.5 percent of all revenue passenger miles flown. In 1950—12 years later—these four major lines accounted for

[178] Mrs. Keyes full study is printed in the separately bound appendix to the hearings.

[179] Because of the manner in which the GAO conducted its study and the way in which the statistics submitted by the Board were gathered, it is not clear that they support the intended conclusion: that about 10 percent or so of major additional competitive route applications were granted in the late sixties, and a far smaller percentage were granted in the early seventies. For this reason, the subcommittee staff requested from the Board a more specific count of the number of applications that were received asking for authority to provide nonstop service on a segment on which the applicant had at the time of application no nonstop authority, along with an account of how such applications were treated. The Board's staff felt that the work involved—which they estimated at 100 man-days—was unwarranted in light of the fact that the numbers produced would simply confirm the conclusions stated here. In light of the CAB staff's view that the *conclusions* drawn from the GAO and previously submitted material are accurate, the subcommittee agreed that the additional work would be unwarranted.

[180] See appendix to hearings. The only significant new entry into the local service business has been the certification of Air New England in 1974.

TABLE 10.—REVENUE PASSENGER-MILES IN SCHEDULED DOMESTIC SERVICE, 1938 AND 1972

Carrier	1938 revenue passenger-miles (billions)	Percent of total
American	0.141	29.6
United	.109	22.9
Trans World	.072	15.1
Eastern	.071	14.9
All others	.083	17.5
Total	.476	100.0

Carrier	1972 revenue passenger-miles (billions)	Percent of total
United	25.194	22.0
American	17.192	15.0
Trans World	13.581	11.9
Delta	13.536	11.9
Eastern	13.252	11.6
Western	5.449	4.7
National	5.233	4.6
Continental	4.623	4.0
Braniff	3.725	3.3
Northwest	3.658	3.2
All local service	8.899	7.8
Total	114.342	100.0

Source: "Air Carrier Traffic Statistics, December 1972. Annual Airline Statistics," Domestic Carriers, 1938.

68.9 percent of all revenue passenger miles; in 1972 they accounted for approximately 60 percent. During this 34-year period while the market share of the "Big Four" fell approximately 20 percentage points, the industry itself mushroomed into a system 238 times larger than in 1938. United, the largest airline, accounted for 22.9 percent of the market in 1938; it accounted for 22.0 percent in 1972.[181]

Finally, the Board has not allowed any carrier to go bankrupt. Rather, it has approved mergers between weaker and smaller firms. Thus, of the 16 trunk carriers in business in 1938, 10 remain. The others have merged with several of these 10. The nine existing local-service carriers are the survivors of the 19 airlines allowed to enter the local-service industry at the end of World War II; the remainder have merged with these 9. Thus, no new domestic trunkline has ever been authorized, and only one new local-service carrier has been authorized since 1950.[182]

It seems unlikely that congressional sponsors of the Federal Aviation Act intended that the CAB so categorically exclude newcomers to the industry.[183] The two main Senate sponsors of the act, Senator McCarran and Senator Truman, repeatedly reassured critics that the act would not make the aviation industry the exclusive preserve of the existing carriers. Thus, when Amelia Earhart argued that the Board might block "a pioneer" that would otherwise serve "two centers of population exceedingly well if permitted to go ahead," Senator McCarran replied,

[181] The 1972 figure includes the assets United obtained through merger with Capital Airlines.
[182] Air New England.
[183] See Keyes study in separately bound appendix to hearings.

You do not understand, do you, that under this bill he would be held up.
Miss EARHART. I think so.
Senator MCCARRAN. He could apply for a certificate of convenience and necessity * * *.
Miss EARHART. Perhaps so. But you know that the mills of any legislative body grind exceedingly slow.[184]

And when Carl Crowley, the Post Office Department's solicitor, complained that the act would inhibit competition, Mr. Truman replied: "There is no competition being throttled in this industry."

Truman relied upon the fact that carriers could "get a certificate of convenience and necessity." In light of this fact he said the Post Office Department's opposition was based upon a failure to read the bill carefully and upon the "ridiculous assumption" that the regulatory commission would abuse the powers delegated to it. Truman told Crowley that in assuming the Board would not let new firms into the industry, he was "just assuming now that the Commission is going to be biased or prejudiced." Crowley responded:

There is nothing to prohibit it, Senator.
Senator TRUMAN. Of course, you have got to assume that you can trust somebody. Every bill that we draft up here, perhaps, unfortunately, makes it necessary to have to trust somebody.[185]

Colonel Gorrell, the president of the Air Transport Association, the major private supporter of the Act, testified that the Act "will bring in a number of new companies and there will be additional airline service." Nothing would "stop lines from being put into operation between points A and B, except the question of public convenience and necessity."[186]

Thus, Senator King of Utah asked Truman in floor debate "just how far the bill freezes existing routes and corporations, for if it excludes * * * others who may desire to enter this great field, then I think there should be some amendments * * *." Senator Truman and Senator McCarran could reassure him that no such event was likely by pointing to the sections dealing with certificates of public convenience and necessity.[187]

Although the final act reflects the diverse views of a variety of sponsors, it seems clear that Congress did not intend the Board to providing existing grandfather carriers with complete protection from new entry nor to reserve the aviation industry as their exclusive domain.[188]

2. The Board's procedures.

a. In General

The Board has developed and enforced its restrictive entry policies, not after open hearings and a policy decision made publicly and consciously, but through the use of procedural devices that inhibit the awarding of routes. The most obvious of these devices is simple delay. More than two-thirds of all route applications (relating to the 100 most traveled city-pairs in the United States) pending on Janu-

[184] Testimony of Amelia Earhart, hearings on S. 3027 before a Subcommittee of the Senate Committee on Interstate Commerce, 74th Cong. 1st sess. (1935), p. 105.
[185] See Hearings on S. 2 and S. 1760 before a Subcommittee of the Senate Committee on Interstate Commerce, 75th Cong., 1st sess. (1937), pp. 305–308.
[186] See hearings on H.R. 5234 and H.R. 4652, House Committee on Foreign and Interstate Commerce, 75th Cong., 1st sess. (1937), p. 5, 112–113.
[187] 83 Cong. Rec., pp. 6851–52 (1938).
[188] See generally the legislative history cited in the memorandum submitted by former Senator Joseph C. O'Mahoney with respect to the right of entry in air transportation under the Civil Aeronautics Act in hearings on Monopoly Problems in Regulated Industries Before the Antitrust Subcommittee of the Committee on the Judiciary, House of Representatives, 84th Cong. 2d sess. at p. 923 (1957).

ary 20, 1975, had been pending for more than 2 years. More than 27.0 percent had been pending for more than 5 years. More than 8 percent had been pending for more than 9 years.[189] These statistics understate the magnitude of the problem considerably because as a general rule applications that have been pending before the Board for more than 3 years are automatically subject to dismissal as stale.

Although delay is a common problem in administrative proceedings, the Civil Aeronautics Board has used other devices, not found in other administrative agencies, that bias the route application process against newcomers and inhibit the awarding of new routes. To understand how these devices work, one must understand the procedure for obtaining a route:

First, a carrier files an application containing certain basic information. A number of other carriers may then intervene in the proceeding: Some interveners would actually like the route themselves; others file protectively, hoping that the route will not be awarded to any one not now serving it.

Next, one of the carriers must file a motion with the Board to expedite the hearing. At this stage the carrier's filing includes detailed information about cost, revenues, and traffic. Such motions are often contested by other carriers.

The Bureau of Operating Rights is the staff component of the CAB which analyzes pleadings and makes a recommendation to the Board as to a proposed disposition of the request. The Board will then decide whether or not to grant the motion for expedited hearing; if it grants the motion, the case is set for hearing.[190]

The next step is a prehearing conference before an administrative law judge. The purpose of the conference is to define and to simplify the issues and scope of the proceeding. The judge issues a report of the conference, defining the issues, specifying a schedule for the exchange of exhibits, and setting a date for the hearing itself. The prehearing conference is a crucial part of the proceeding, for the definition of the issues in large part determines the outcome of the case.

The hearing itself is then held. Then, either the administrative law judge will make an initial or recommended decision, or the case itself may be certified to the Board for its decision. If the former, the Board may, in its discretion, review the initial decision.[191]

The most surprising and disturbing feature of this procedural system is the motion for expedited hearing. Although the motion appears on the surface to relate solely to procedure, the Bureau of Operating Rights, in its study of Board route policy, points out that the decision to grant priority—to expedite the hearing—actually determines whether or not the application will be passed on at all. "The decision to hear city-pair route issues in a formal proceeding

[189] Keyes study reprinted in the separately bound appendix to the hearings.
[190] In addition, the Board itself may initiate route proceedings by issuing an order of investigation.
[191] See, S. Glass, "Law and Procedures Regarding Major New Route Proceedings Before the Civil Aeronautics Board," at pp. 6–24, Library of Congress, 1975, reprinted in the separately bound appendix to the hearings.

has meant, as a practical matter, that new or additional authority will in fact be awarded." [192]

If the motion to expedite the hearing is not decided or if it is denied, however, the application stays on the docket for 3 years and then is dismissed as stale. Thus, when World Airways requested authority to fly between Los Angeles and New York for $75, for example, the Board simply refused to grant World an expedited hearing, and World's application was later dismissed as stale.[193] It is extremely difficult for a carrier to obtain court review of this procedural decision denying it a route, since its application is not officially denied but remains pending for 3 years then it is dismissed as stale; it thus appears to a court that the application was dismissed for procedural—rather than substantive—reasons.

The CAB justifies this procedure as necessary to order and organize its docket.[194] Applications may not warrant a hearing; a carrier, for example, once applied for a route to the Moon. Nonetheless, courts and other agencies have found that the best way to deal with applications that plainly lack merit, is to use some form of summary judgment. If an application lacks merit so that a hearing is pointless, the application can be summarily dismissed. A dismissal on the merits would allow the carrier that believes the Board acted unlawfully to ask for court review of the dismissal. The Board's present procedure keeps the carrier in limbo: It grants, neither a hearing nor a route; at the same time it does not allow the carrier to appeal a denial to the courts.[195]

A second disturbing general feature of the Board's route procedures is that the Board has no fixed standards for determining whether a route will be awarded or what carrier will be awarded the route. The Board's Bureau of Operating Rights states that the Board in route cases asks two questions: First, does the market need new service? Second, if so, which carrier should supply that service? The first question is usually answered on the basis of a) whether the markets are large enough to support additional service and b) whether existing service is deficient. If these questions are answered positively, then one or more new carriers are selected to provide additional service. The BOR concludes on the basis of its study of the Board's route cases involving first competitive service that the cases were systematic in the decisional result as to the authorization of competitive authority *but random as to carrier selection.*[196]

This BOR conclusion is confirmed by the Keyes study, which points out that in selecting carriers the Board has used a number of standards, including: (1) Can the carrier render effective service responsive to the needs of the traveling public? (2) Is the carrier able to provide benefits to beyond segment traffic? (3) Will there be route integration? (4) What points are involved? (5) Has the carrier historically participated in this traffic? (6) Will traffic be diverted from other carriers? (7) Does the carrier have need for strengthening? Keyes concludes that, since

[192] See BOR study at p. 38. The study adds: "The Board decides to hear or not hear route applications usually on the basis of whether a motion for an out-of-town hearing has been filed pursuant to section 399.60." BOR study at p. i.

[193] Hearings at p. 537 (prepared statement of William A. Hardenstine, senior vice president and director, World Airways.)

[194] Hearings at p. 651 (testimony of G. Joseph Minetti, member, CAB); BOR study at p. 39, note 1.

[195] The merits might be determined in a summary proceeding based upon a BOR determination.

[196] BOR study p. 53

these factors are so numerous and since the underlying facts are seldom precisely comparable from case to case, the carrier choice does not appear to be comprehensible in any sense that would assure that the standards are being applied consistently in any large proportion of contested cases.[197]

This is not to say that there are no guiding principles. Rather, Keyes, the BOR, and the Library of Congress agreed that the Board made an effort to award routes in a way that tended to promote carriers' efficient integrated systems. Yet, so many other factors were also at work that the relative weight to be given each of these factors in future individual cases is extremely difficult to predict.[198]

Thus, the strong criticism of the Board that Judge Friendly voiced 16 years ago—that the Board did not use comprehensible standards in its route cases—is valid today despite the passage of 16 years.[199]

b. The Route Moratorium

The problems discussed above have plagued the Civil Aeronautics Board for some time. Within the past few years, however, CAB route policy has become still more restrictive. The development and implementation of this new unusually restrictive policy—the Board's route moratorium—raises particularly serious questions of procedural propriety.

1) The policy—The term "route moratorium" refers to the CAB's general failure to hear—and almost complete failure to grant—applications for new routes. The GAO statistical study summarizes this tendency as follows: [200]

TABLE 11.—APPLICATIONS FOR NEW DOMESTIC ROUTE AUTHORITY

	Number of applications for 5-yr. period	
	July 1, 1964 to June 30, 1969	July 1, 1969 to June 30, 1974
Granted	14	2
Denied or dismissed after hearing	53	14
Dismissed without hearing (stale)	22	8
Withdrawn by applicant	11	1
Pending at period's end	23	47

To quote the CAB's 1974 staff study, "Since approximately 1970, cases involving new domestic route authority have generally not been set for hearing." [201] As William Caldwell, the Chief of the Board's Bureau of Operating Rights, stated, "Since I have been Bureau Director we have not had any new entry." [202]

[197] Keyes study at p. 26, reprinted in the separately bound appendix to the hearings.

[198] It should be noted that the BOR study itself proposes a set of standards designed to help cure the problem. These standards are discussed at note 250, infra.

[199] See Friendly, *The Administrative Agencies* chap. 5 (1962). See also Antitrust Subcommittee of the House Committee on the Judiciary, H.R. Report No. 517, 85th Cong., 2d sess. 268 (1957) (criticizing CAB's lack of rate standards).

[200] Reprinted in the separately bound appendix to the hearings.

[201] BOR study at p. i.

[202] Hearings at p. 1373. Board notation 3320, p. 6 adds "Route cases involving new competitive authority or which otherwise have diversionary implications—other than merger cases—have not gone forward. The Board has not instituted any such case on its own motion and carrier and civic applications accompanied by petitions for expeditious considerations or filed under expedited procedures have either been dismissed or deferred." P. 6 (Oct. 2, 1972).

Initially, the Board denied to the subcommittee that there was a route moratorium.[203] But when it was pointed out that the industry, the Board's staff, and the trade press continuously referred to its "policy of caution" as a "route moratorium," the Board conceded that these different terms are equivalent.[204]

Several of the scheduled airlines gave specific examples of route applications ignored by the CAB. In December 1971, Allegheny Airlines applied to remove a restriction which prevented nonstop flights between Louisville and Memphis, a route on which American Airlines had allowed nonstop service to decline to one flight per day. American objected to the application and the Board simply took no action upon it.[205]

Since 1972 the Board has refused to grant hearings on three other Allegheny applications to remove restrictions that would prevent Allegheny from competing on three other routes where American has a monopoly: Cleveland–Cincinnati, Cleveland–Louisville, and Cleveland–Rochester.[206]

North Central testified that prior to 1970 it obtained a very large percentage of the routes it applied for, but since 1970 it had received no new route awards. Despite several applications, North Central has not had a hearing granted on an application for route authority since July 19, 1969.[207]

Pan American has petitioned the Board for the right to fill up its planes with traffic flying between New York and California—Pan Am planes that fly between New York and California anyway as part of their international route. It is patently wasteful to fly these planes half full while preventing willing New York passengers from boarding in San Francisco. Nonetheless, the Board denied Pan Am's petition for fill-up rights.[208]

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[203] See Hearings at p. 648 (testimony of Acting Chairman O'Melia).

[204] Hearings at p. 649.

Mr. O'MELIA. * * * This practice of the Board has been subject to severe criticism, to the point that it has been characterized by its critics as a "route moratorium." I think you will find, Mr. Chairman, if you examine the Board's decisions, and the public remarks made by Board members and by its senior staff officials, that this characterization does not truly reflect the Board's policy. On the contrary, the Board is keenly aware of its statutory mandate to be responsive to route applications and to act upon them as speedily as possible in keeping with the circumstances of each such application and with the judgmental decisions, with which it is also entrusted.

Senator KENNEDY. Mr. O'Melia, how can you say tehre has been no route moratorium? How many competitive route applications were actually set for hearings in 1973 or 1974?

Mr. O'MELIA. Well, there are several points I would like to make. During the sixties, as you heard this morning, there were a lot of route cases. In early 1970 there was a downturn in the economy. The cases that came before the Board were very few. There was no Board policy stating that there was to be a moratorium. In 1973 we experienced the fuel shortage from the fall of 1973 until the summer of 1974 the carriers were trying to find fuel, not trying to find new routes to operate.

Senator KENNEDY. Were there applications during this period of time?

Mr. O'MELIA. I am not sure. There probably were. Normally there are about 1,000 docketed cases a year of which 300 or 400 of them are route cases. Of those I am not sure how many are normally filed for expedited consideration, which would then bring them before the Board.

Senator KENNEDY. As I understand it, even though there were no hearings that were set during this period of time, and even though you have claimed there was no moratorium, the staff study itself opens by saying that since approximately 1970, the cases involving new domestic route authority were generally not being set for hearing. How else would you characterize the policy of the CAB? Isn't that really a moratorium—are we just fencing on words here?

Mr. O'MELIA. As one Board member, let me give you as straight an answer as I can, Senator. During my hearings before Senator Cannon when consideration was being given to my nomination as a member of the Board I answered the question of the route moratorium two or three times. I said I was not in favor of a moratorium, that I felt that if cases are filed, and if the applicants ask for expeditious hearing, that they should be heard. Now this is in the record of those two hearings.

[205] Hearings at p. 624 (prepared statement of Edwin I. Colodny, executive vice president of marketing and legal affairs, Allegheny Airlines).

[206] Id.

[207] Hearings at p. 541 (testimony of Raymond J. Rasenberger, counsel, North Central Airlines).

[208] Hearings at p. 643 (prepared statement of Stuart G. Tipton, senior vice president, Foreign affairs, Pan American World Airways).

This change of Board route policy in 1969 was significant. Prior 1969, the Board would grant a certain number of route application after 1970, it simply refused to set any competitive route cases fo hearing. It enforced a "route moratorium."

2) The formation of the route moratorium.—The Board's rout moratorium was instituted secretly and through highly improper pro cedures. The Board did not announce that it was considering a chang in policy, nor did it hold hearings on whether it ought to consider change in policy. Rather, the new policy was introduced through series of speeches to industry, through instructions transmitted to th Board's staff, and through the procedural device of simply refusing to set individual route cases for expedited hearing.

Former Board Chairman Secor Browne described in an interview with the subcommittee staff how the route moratorium arose. In 1969 and 1970 Mr. Browne and several other Board members became concerned by over capacity in the industry. Industry representatives mentioned this matter to Board members during informal off-the-record meetings in Board members' offices.[209] Board Member Minetti testified, for example, that

> The phrase "route moratorium" came up in 1969 after the Board had decided a number of cases. I think at that time some of the carriers came in and suggested to the Board that we have a route moratorium to give them an opportunity to digest the new routes they had received. This was not shared by all the carriers, but the Board felt it should have a route moratorium. That is how the phrase "route moratorium" came up. [210]

Chairman Browne then gave a series of speeches to the industry calling for route restraint. In February 1972, for example, in stating that capacity must be restrained, he added: "Since I have been Chairman there have been no new major route cases set down before the Board." He repeated these and similar remarks many times over a period of months. When Mr. Browne left the office in 1972,[211] and Mr. Timm became Chairman, he, too, in a series of speeches, told the industry that the Board would not set down route cases except in very unusual circumstances.[212]

Mr. Browne did not discuss the wisdom of this policy with other members of the Board before giving these speeches, for, he said, Board members are free to give whatever speeches they wish.[213] Had there been consultation, however, Mr. Browne might have found that Member Minetti objected, for he testified:

> I have no problem with the policy of caution in setting down a route case during time of financial difficulty. What I disagree with is carrying the policy of caution to the point of refusing to hear any route cases. I still think hearing no such cases is inconsistent with the mandate of the statute.[213a]

As a result of these speeches, administrative law judges and members of the Board's staff recognized that the Board's policy was not to award new routes. Some Board staff members felt that word about the new policy also filtered down to the staff as a result of discussions

[209] See Hearings at p. 1361 (memorandum of conversation with Secor Browne).
[210] Hearings at p. 652. Mr. Browne stated that he would discuss in his office a number of subjects with the carriers including their labor problems, their airport problems, and in particular the need for some form of route moratorium. *Id.* p. 1361 (memorandum of conversation with Secor Browne).
[211] Mr. Browne is now an airline consultant in Washington, D.C.
[212] Prepared statement of James Gagnon, chairman, ad hoc committee on air service, Airport Operators Council International, attachment B, p. 41. [This attachment was inadvertently omitted from the printed record.]
[213] See Hearings at p. 1361 (memorandum of conversation with Secor Browne).
[213a] Hearings at p. 653. (testimony of G. Joseph Minetti, member of CAB).

etween Mr. Browne and his top staff, but Mr. Browne did not recall ich discussions. In any case, there was no need for such discussions, e stated, for the staff would read the speeches and "would act." [214] As result the Board and the staff simply did not act on route cases; simply would not provide hearings.

The reason often given by the Board for refusing to hear route ases—the lack of administrative resources—was not its basic reason. ndeed, in 1972 a memorandum from the Board's Bureau of Operating ights makes plain that "administrative resources are now becoming vailable to begin an expanded route program on a systematic basis." [215] ather, the basic reason was a policy decision by the Chairman, taken ithout hearings or formal consultation with other members, to slow own the granting of route awards.[216]

The result of this series of actions was a policy that froze the warding of new routes for several years. That policy has engendered idespread opposition. The Airport Operators Council International, or example, representing airports that account for 90 percent of total .S. passenger air markets, criticized the moratorium as "literally bliterating vast opportunities for economic growth by carriers and ties alike." [217] Cities such as Las Vegas and Baltimore have argued at it was desirable to relax the route moratorium in order to "allow w carriers to get new markets and access to new markets" where ey have been denied access for a long time.[218] Many carriers—articularly smaller carriers—strongly opposed the moratorium.

Procedural defects.

a. Lack of Opportunity To Be Heard

The basic reason for requiring open hearings before major policy ecisions are made is to provide a fair opportunity to expose the proofs nd arguments for and against a proposed change. No such opportunity as granted in the case of the route moratorium. Yet it was sorely eeded. On the one hand, several Board members believed that a more strictive route policy was necessary because of low industry profits 1970–71. Indeed, the largest scheduled air carriers argued strongly roughout that period that, in order to maintain the health of the dustry, mergers, capacity restricting agreements, controls on service, rther restrictions on the supplemental carriers, and a moratorium on w route awards were all desirable.

Yet, there were also strong arguments on the other side. First, ere was no evidence that new route awards in the late sixties had ything to do with carrier losses in 1970 and 1971. Rather, the aller, more efficient carriers in that period were still earning profits; nd, of the two carriers that lost the greatest number of new route ards to other carriers—Delta and United—one remained profitable nd the other was able to show at least a nominal return on invest-ent.[219] Overcapacity, rather, flowed from the industry's over-

[214] Hearings at p. 1361 (memorandum of interview with Secor Browne).
[215] Notation 3320, p. 41 (2, 1972), reprinted in separately bound appendix to hearings.
[216] Hearings at p. 1361 (i view with Secor Browne, former Chairman, CAB). When asked whether he discussed this matter h members of the Board's staff, Mr. Browne said he had not, there was no d to do so, for the staff members would read his speeches and would act accordingly.
[217] Hearings at p. 709 (prepared statement of James Gagnon, chairman, ad hoc committee on air service, port Operators Council International).
[218] See Hearings at p. 1759 (testimony of Richard Taylor, counsel for Erle A. Taylor, director of aviation, rk County, Nev.): p. 1777 (prepared statement of Robert J. Aaronson, administrator, State aviation dministration of the Maryland Department of Transportation).
[219] See Hearings at p. 583 (testimony of Continental Airlines).

optimistic expectation of future demand for air travel and resulting over-investment.[220] And second, there were strong arguments that to restrict route awards was precisely the wrong remedy. The Department of Transportation and the Department of Justice believed, for example, that a more liberal, not a more restrictive, entry policy, if coupled with increased freedom for carriers to experiment with different price levels, would fill up excess capacity, and lower passenger fares to boot.[221] It might also have been argued that the carriers themselves should suffer the fruits of an incorrect investment decision instead of relying upon the Board to increase their profitability by preventing additional competition.

Given this divergence of view as to the proper solution, and given the importance of a major change in the Board's policy of awarding routes, public hearings focusing on the change of policy itself obviously would have been desirable.

b. Lack of Opportunity To Appeal to the Courts

A second serious problem with the highly informal procedure used by the Board to develop and to implement its newly restrictive route policy is the difficulty created for any carrier or other party wishing to challenge the policy's legality in court. Mr. Rasenberger, counsel for North Central Airlines, testified, for example,

> It is very difficult, Senator, [to test the legality of the Board's policy in court] because what you would take to court is an order in one case. But you are dealing with a policy which is not announced and which is reflected only by the accretion of case-by-case denials. You cannot take a bunch of cases to court; you've got to take one. And, in no particular case can you prove on the record of that . . . [that] the decision is pursuant to a general policy of a route moratorium. As you perhaps know, the courts are reluctant to interfere . . . in questions that involve the agency managing its own docket . . . That is why . . . a moratorium is such an insidious way of getting at precluding hearings on applications—because it is so hard to get judicial review.[222]

The combination of (a) the Board's practice of determining the merits of a route case on the procedural motion for an expedited hearing, (b) its refusal to hold a hearing on the matter of a general change in its route policies, and (c) the Board's claim that its failure to grant hearings are simply a matter of controlling its own docket, combined to make judicial review difficult—or impossible—to obtain. Moreover, any carrier successful in proving that the Board wrongly changed its route policy without a hearing, or challenging the Board's decision successfully in some other way, would obtain as judicial relief only an order for a new hearing before a now-hostile Board. Since the standards used by the Board in granting route awards are so vague, it is unlikely that the carrier could force the Board to award it a route. Thus there was little incentive to mount a court challenge.

4. The legality and propriety of the moratorium.

As a number of witnesses testified,[223] the CAB's route moratorium was probably unlawful. The Federal Aviation Act specifies that an

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[220] Trans World Airlines exhibit TWA-24, dated Apr. 26, 1974, *Capacity Reduction Agreements Case*. (CAB docket 22908). Hearings at p. 2158.

[221] See Hearings at pp. 688-690 (Department of Transportation statement).

[222] See Hearings at p. 544 (testimony of Rev. Rasenberger, counsel, North Central Airlines); pp. 664-72 (testimony of Donald Baker, U.S. Department of Justice).

[223] Id.

application for a route "shall be set for a public hearing and the Board shall dispose of such application as speedily as possible." [224] While it is well-established that the Board may set a nonchronological order for deciding the matters on its docket,[225] this authority to control its docket must be interpreted in light of section 401(c)'s mandate to act as speedily as possible. It is difficult, if not impossible, to construe this mandate to permit the Board's practice of withholding action until an application is so stale that it must be dismissed. If, indeed, the Board is besieged with frivolous route applications that do not warrant a hearing, it can always dismiss them summarily.

The Administrative Procedure Act also specifically provides that "with due regard for the convenience and necessity of the parties * * * and within a reasonable time, each agency shall proceed to conclude a matter presented to it." [226] The House committee report on the APA says that the purpose of this section is to guarantee that no agency "shall in effect deny relief or fail to conclude a case by mere inaction, or proceed in a dilatory fashion to the injury of the person concerned." [227] And the Senate committee report stated that it was a "legal requirement" for an agency not to conclude a case by inaction.[228]

The Board's use of its power to fail to grant hearings in order to restrict route awards may also have violated the basic principle that an agency must not contravene its own rules. The Board's published standards for determining priorities of hearing include (1) the "impact of delay," (2) the "need for promptly securing compliance with the provisions of the Act," (3) the "time for which the matter has already been pending," (4) the possibility that "a proposal might reduce subsidy," (5) whether an application "proposes new service," (6) "the volume of traffic that might be affected," (7) "the period that has elapsed since the Board considered the service need of the places or areas involved," and (8) "the relative availability of necessary staff members, of the carriers, communities, and Board." [229]

In CAB orders issued in several individual cases throughout 1973, however, the Board, when describing its "policy of caution in setting down for hearing applications," listed a different set of standards. It stated that it would require a "prima facie showing * * * that the existing service in the market at issue is materially deficient, that grant of the application * * * would result in substantial benefits to the traveling public, and that the applicant carrier could operate the service it proposes on a substantially profitable basis * * * to an extent outweighing the losses that granted the application would

[224] FAA section 401(c), 49 U.S.C. section 1371(c) (1970). It might be argued, however, that authorization to fly from A to C is an *amendment* of a carrier's existing authority if that carrier already flies, say, from A to D. If so, it might be governed by section 401(g) which contains no explicit speedy action requirement. It is more probable, however, that a court would view the awarding of a route between A and C as awarding a new certificate, for a certificate properly speaking is authority to fly from *x* to *y*, *not* authority to fly generally. See *Pan American Airway, Inc.* v. *Boyd*, 207 F. Supp. 152, 158 (D.D.C. 1962).

[225] See, e.g., *Frontier Airlines* v. *CAB*, 349 F.2d 587, 591 (10th Cir. 1965). This line of cases rests upon FAA section 1001, 49 U.S.C. section 1481 (1970), which states that "the Board * * * subject to the provisions of the chapter and the Administrative Procedure Act may conduct their proceedings in such a manner as will be conducive to the proper dispatch of business, and to the ends of justice." Note, however, that the Board's control over its docket is "subject to the provisions of this chapter and the Administrative Procedure Act." Thus, this grant of general authority must be interpreted in a manner consistent with section 401(c)'s mandate for speedy action.

[226] Administrative Procedure Act section 6a, 5 U.S.C. sec. 555(b). The original language of the APA, prior to its recodification is even stronger: "Every agency shall proceed with reasonable dispatch to conclude any matter presented it. * * *" APA ch. 324, sec. 6(a).

[227] See Senate Comm. on the Judiciary, *Administrative Procedure Act—Legislative History*. S. Doc. 24 79th Cong., 2d sess. 263–264 (1946).

[228] Id. at pp. 204–205.

[229] 14 CFR section 399.60 (1974).

inflict on the incumbent carrier or carriers in the market." [230] It is clear that an agency must abide by published regulations even if it had no duty to publish them in the first place.[231] And an agency may not amend its public regulations except by the procedures of the APA. The Board would seem to have violated this principle by using standards not contained in the Code of Federal Regulations—standards determined without opportunity for public debate or comment.

Finally, the Board revised its general route policy, not in a single rulemaking proceeding, but, rather, by simply using the new policy to decide cases. It denied the applications for hearing presented to it on an individual basis without ever soliciting the views of the general public and of the industry.

The Supreme Court has indicated a strong distrust of an agency's use of the case-by-case method for setting major changes in significant agency policy in this way.[232]

Whether or not the manner in which the Board determined and carried out its route moratorium was technically unlawful, in the subcommittee's view its procedures were highly improper. The Board, when considering a major shift in its route policy, should have published notice of its intention in the Federal Register and held a hearing on the proposed change. After the hearing, it should have published its "new statement of general policy or interpretation of general applicability" [233] in the Federal Register, as the Freedom of Information Act requires.[234] Had the Board followed this procedure, all parties would have had an opportunity to argue the merits of the route moratorium, the Board would have been exposed to a variety of other positions about the appropriate way to cure industry problems, and the affected parties would have had an opportunity to challenge a Board decision in the courts. This is not to say full hearings must be held on every minor change of Board policy, but an important change—which affects the industry and the public significantly—such as the creation of a route moratorium, surely calls for more extensive formal public participation than the Board allowed.

5. Other improper procedural aspects of the moratorium.

In addition to the way in which the moratorium was created, the moratorium seems to have been enforced with a lack of regard for procedural propriety.

a. Improper Interference With Existing Cases

A memorandum from Administrative Law Judge Wiser to Board Chairman Timm, written April 2, 1973, lists four cases, and goes on to state "the following route cases, which have been set for hearing by Board order, have not been noticed for a conference and hearing before an administrative law judge pursuant to informal instructions

[230] See, e.g., CAB orders 73-7-78, (1973) 73-7-129 (July 1973), 73-8-24 (1973).
[231] See *United States* (Accardi v. *Shaughnessy*, 347 U.S. 260 (1954); *Vitarelli* v. *Seaton*, 359 U.S. 535 (1959).
[232] See *Wyman Gordon* v. *National Labor Relations Board*, 394 U.S. 759 (1962).
[233] 5 U.S.C. sec. 552(a) (1970).
[234] Moreover, 44 U.S.C. sec. 1510 (1970) requires that all documents in the Federal Register "having general applicability and legal effect" must be codified in the Code of Federal Regulations. Failure to publish the Board's "policy of caution" would seem unlawful on its face. Moreover, section 399.2 of the Board's regulations, stating that it will not publish in the Federal Register policies that are set out "in any opinion, decision, order * * * of the Board" seems inconsistent with 44 U.S.C. sec. 1510 and the Freedom of Information Act, 5 U.S.C. sec. 552 (a) (1) (D).

of the Chairman's office in connection with the unofficial route moratorium." [235]

Evidently the informal instructions referred to were given to an administrative law judge by former Chairman Browne's office. Although Judge Wiser's memorandum referring to these instructions, was sent to Chairman Timm's office, no one took steps to reverse those instructions, nor did Mr. Browne or Mr. Timm inform other Board members. Thus, member Minetti testified:

> Mr. MINETTI. Well as far as I'm concerned in these specific cases, I voted to set these cases down for hearing. As far as I'm concerned when the Board sets a case for hearing, I expect that the case will be heard as soon as there is available an administrative law judge. . . .
>
> Senator KENNEDY. Well, it was not done in this case.
>
> Mr. MINETTI. No, it was not.
>
> Senator KENNEDY. Did they ever talk to you about it? Did the Chairman ever talk to you about it?
>
> Mr. MINETTI. No, he did not. I do not recall it.
>
> Senator KENNEDY. Did he sound you out? Or, to the best of your knowledge was this action taken completely independently by the Chairman?
>
> Mr. MINETTI. To the best of my knowledge, I do not recall the Chairman talking to me about it.[236]

The CAB rules point out that "members of the Board are expected to conduct themselves with the same fidelity to standards of propriety that characterize a court * * *." [237] It would seem to violate accepted judicial canons for the Board Chairman informally to instruct an administrative law judge to postpone a case previously set for hearing, particularly without consultating other members of the Board who had previously voted to grant a hearing and without giving notice to the parties.[238] The matter is still more serious in light of the overwhelming importance that the decision to set a case for hearing plays in the route-granting process.[239] At best, it suggests an insensitivity to generally accepted procedural norms.[240] At worst, it is an unlawful intrusion into the ordinary decisionmaking process designed to affect the result in a particular case.

b. Private Communications

A further problem embedded in the Board's route moratorium procedures concerns the role of private off-the-record conversations

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[235] Hearings at p. 1358.

[236] Hearings at p. 1365.

[237] 14 CFR pt. 300 (1974).

[238] The reader should bear in mind the following: First, former Chairman Browne does not recall the incident in question nor does former Chairman Timm recall receiving or discussing the memorandum sent to the chairman's office on Apr. 2, 1973. Discussions between members of the subcommittee staff and members of the CAB staff have led the subcommittee to conclude that Judge Wiser's memorandum is neither inaccurate nor misleading. Second, an appellate court has virtually no power to control the docket of a lower court; any private instruction from an appellate court judge to a lower court judge to postpone a hearing would obviously be improper; similar discussions among the Board and its administrative law judges are less obviously improper. The evidence presented to the subcommittee shows that the decision to postpone these cases was related to substantive policy—a desire to slow down or stop the awarding of new routes—not to any neutral effort to cure problems of an overcrowded docket. Hearings at pp. 1358-65.

[239] See pp. 82–84, supra.

[240] A further example of the loose or uncertain criteria governing the relations between Board members and administrative law judges may be revealed by the following testimony:

> Mr. TIMM. When I came to the Board I was aware of the (route policy)—it was a feeling of proceeding carefully and slowly . . . After I had been there a very, very short time—perhaps 2 weeks—there was a case that involved a city that is near my hometown. So I called the law judge to ask about that, not knowing how these things were handled at the Board. And, I was informed at that time—this is the case of Spokano to Montana—that whenever a law judge would be available the case would be set down." Hearings at p. 1794.

Given the overwhelming importance that the procedural decision to set a case for hearing plays in the route award process, a call from a Board member's office inquiring about a case's "status" may have a significant effect on the eventual disposition of that case. On the other hand, Board members sometimes need to make a legitimate inquiry about a case's status. This dilemma simply points out an additional reason why it is wrong to use procedural decisions—such as a decision to set a case for hearing—to make a decision about the substance of a case.

between Board members and representatives of industry. Former Chairman Browne has stated that industry representatives came to see him frequently between 1969 and 1971. There visits were often "courtesy calls," yet matters of substance were discussed. In particular, Mr. Browne would listen to industry complaints about overcapacity, low carrier profits, overly aggressive labor, and various other subjects of industry concern.[240a] And, as Board Member Minetti told the subcommittee, the larger carriers were urging the adoption of a route moratorium.[241]

An examination of the calendar and logs of members of the Civil Aeronautics Board for 1974 reveals that such private meetings are by no means uncommon. During that year there were 769 such meetings between Board members and members of the industry, as the following table reflects:

TABLE 12—CONTACTS BY MEMBERS OF THE CIVIL AERONAUTICS BOARD WITH INDUSTRY REPRESENTATIVES (CALENDAR YEAR 1974)

	Board Members					
	1	2	3	4	5	Total
January	30	13	22	13	13	91
February	31	10	5	14	4	64
March	16	9	12	11	1	49
April	34	4	14	7	4	63
May	32	7	19	18	3	79
June	40	9	6	16	6	77
July	21	7	21	6	5	60
August	46	5	18	5	0	74
September	32	7	10	10	3	62
October	23	10	16	14	1	64
November	10	8	12	13	1	44
December	14	3	13	12	0	42
Total	329	92	168	139	41	769

Source: This table was compiled by the Subcommittee on Administrative Practice and Procedure based upon information submitted by Board members for the calendar year 1974.

Large numbers of private meetings—while not necessarily improper on an individual basis—raise a problem of public confidence in the agency. Whether or not a Commission member can maintain perfect objectivity (and constant exposure to the industry viewpoint makes objectivity more difficult), the public is uncertain whether, in fact, decisions of major importance have been made on the merits for reasons set out in the public record. This concern is multiplied when private meetings with major members of the industry are followed by speeches that espouse their point of view, which in turn are followed by the translation of that point of view into formal Board policy, all without benefit of hearing or court review [241a] as occurred in the case of the route moratorium.

Moreover, the problem of confidence is aggravated by the well-known fact that the industry is an important source of future jobs for Board members (see table 13). Furthermore, frequent travel by Board officials on "inaugural flights" may suggest to the public certain unseemly coziness between the regulator and the regulated, despite the legality of such travel.[242]

[240a] Hearings at p. 1361. (But compare with Hearings at p. 1362.)

[241] Hearings at p. 652 (testimony of Member Minetti). This statement was confirmed by former Chairman Browne, who stated that TWA and United were among leading proponents of a more restrictive route policy. See staff memorandum, interview with Secor Browne, Hearings at p. 1361.

[241a] Of course, applicants in individual cases received opinions from the Board explaining why the application for hearing was denied. For reasons previously mentioned, however, this is not a satisfactory alternative to a full hearing concerning the merits of a proposed major change in policy.

[242] Hearings at pp. 1393–96.

The problem is difficult, however, for it seems unwise to forbid all meetings between members of the industry and the Board. To do so risks enclosing Board members in an "ivory tower" from which the isolated Board member may find it more difficult to obtain important, relevant information. It is also probably desirable for Board members to meet major industry figures personally, in order to have some idea what the men are like who run the airlines

Member West articulated this tension very well:

I am aware that the appearance of a fair hearing and a fair opportunity and fair treatment is oftentimes as important as the fact that you oftentimes receive fair treatment, and I am not at all arguing that there is not a basis for concern about kind of a persuasive influence.

But I am a bit disturbed that there may be some rules that almost require you to live in a vacuum to prevent you from—now, I have been accused of not being an expert in this field, and I plead guilty, but I am not sure how, if we are restricted to almost a vacuum-like atmosphere, that we would be able to even determine what the questions are, let alone the solutions, and there is a problem in my own mind about how to conduct myself.

I came from the bench in which the rules are more clearly defined. In all fairness, you have to be—you understand what matters can be discussed and under what circumstances, but here we are in a quasi-judicial situation, and it is different, and I have not yet defined or determined the difference that exists.

In some respects, we are held to the same rigid standards that a court is held, with regard to making decisions, and yet, we are determining policy in which all sorts of inputs should be received before you can make very much of a quality decision, and where I can obtain that is a bit of a problem without some contact with the industry.[243]

TABLE 13.—SELECTED BIOGRAPHICAL DATA OF CAB BOARD MEMBERS

[1938–75]

Profession:	
Law	24
Engineering	4
Economics	1
Journalism	1
Other	4
Pre-Board activities [1]	
Jobs with regulated firms:	
Attorney	2
Employee	4
Jobs relating to regulated firms:	
Other firms	4
Government other than Board	17
Congressmen	5
Staffs of President, Congress, political parties	6
Other	5
CAB	1
Post-Board activities:	
Jobs with regulated firms:	
Attorney	9
Employee	4
Jobs related to regulated firms:	
Other firms	2
Government other than Board	5
Retired	5
Incumbents	5
Other	4

[1] The total for this category exceeds the sample size because some individuals were found to have multiple professional listings

Source: R. Eckhardt, "What Do Regulatory Commissioners Maximize?" (Amos Tuck School, Dartmouth College) updated by the subcommittee staff

Other agencies have tried to resolve this dilemma by having Commissioners keep logs of daily visitors and opening those logs to the

[243] Hearings at p. 1384.

public.[244] The CAB might do the same. Additionally, it might be desirable to broaden somewhat the agency's definition of ex parte contacts. Currently the Board's regulations forbid private discussion of matters pending before the Board entirely, but they do not forbid at all discussion of policy matters that soon may become the subject of a Board proceeding. The Board might adopt a middle ground for topics that soon may become the subject of Board proceedings. Rather than forbidding them entirely or freeing them from all restraint, Board members might be required (depending upon the importance of the subject matter discussed) either to keep transcripts of such conversations or to publish summaries of the discussion.[245] Finally, Board members can individually make efforts to meet with representatives of consumer groups as well as those of industry.

c. BOR Notations

A further indication that the "route moratorium" represented a basic shift in the Board's policy toward protecting carrier profits is provided by the manner in which Bureau of Operating Rights notations were written. Mr. Caldwell, the chief of the Bureau of Operating Rights, told the members of his staff that all memorandums dealing with route awards would have three sections: (1) A recommendation, (2) a description of the effect of the route award on the industry's rate of return, (3) a discussion about the basis for the recommendation.[246] The declaration of policy set forth in section 102 of the Federal Aviation Act, however, does not single out the "effect on industry rate of return" as a matter of singular importance. It does direct the Board "to foster sound economic conditions in the industry;" thus, industry rate of return is plainly relevant. But the act also states that the CAB is to consider "adequate, economical, efficient service at reasonable charges." The BOR staff was not instructed to include a section entitled "Likely Effect on Rates," or "Effect on Inflation," or "Effect on Energy," or any other effect that might be of importance to the making of a route decision. The new manner of writing instructions signaled to the staff members and to the Board that the effect on industry rate of return was the most important factor governing entry decisions.

The matter is of significance, for BOR memorandums are used by the Board in deciding whether to grant a hearing. This decision, in turn, determined whether a route award might be made. These memos, containing private advice to the Board about a "procedural" decision, were never made available to the parties for discussion or criticism. Given the procedural context, these memos posed one additional obstacle in the paths of carriers seeking new routes—an obstacle that is important because of the absence of open hearings for determining route awards and route policy. It also illustrates how a decision to change the direction of major Board policy—toward placing major emphasis upon the protection of carrier profits—can become embedded

[244] On Apr. 14, 1975, the subcommittee opened hearings on S. 1289, a bill introduced by Senator Kennedy to require the maintenance and disclosure of records of contacts between outsiders and high level agency officials. See 121 Cong. Rec., S4863 (March 22, 1975) (introductory remarks by Senator Kennedy).

[245] S. 799, introduced by Senator Kennedy and Senator Mathias, extends the restriction on ex parte contacts of 5 U.S.C. sec. 554(d) to formal rulemaking (but does not reach contacts on proposed rules *before* they are formally proposed).

[246] See Hearings at p. 1368. The memorandum sent on Mar. 19, 1973, from William B. Caldwell, Jr., to all BOR division heads states simply "on all future notation items I would like a new section following the recommendation section: Effect on Industry's Rate of Return."

in agency procedures in a way that makes a reversal of direction by a future Board less likely.

d. The Basic Procedural Defect

The practical effect of the use of the procedures discussed above has been (1) to prevent the awarding of any routes that would have meant additional competition in existing markets; (2) to prevent judicial review of most specific cases by avoiding the entering of any final order; and (3) to avoid either judicial review or open public debate of the Board's "route moratorium" by failing to announce a general regulation to that effect. In short, the effect of the Board's policy has been to protect the airlines that have routes from those which are applying for new routes, while avoiding any independent scrutiny of the basis of that policy.

The Board's extreme difficulty in developing a coherent set of standards for awarding routes may help to explain why it has chosen to follow this highly improper procedural path. A failure to follow consistent, coherent standards subjects the Board to criticism [247] and, more importantly, runs the risk that courts will reverse the Board's decisions. Moreover, a route case, without clear standards, becomes lengthy and infinitely complex. Thus, it is tempting to cast the route award decision in the mold of a decision to "expedite a hearing," for then the Board is relieved of the need to apply, precisely and stringently, uniform route-award standards, the courts are less likely to reverse the decision, the proceedings can be shortened, and outside commentators are less likely to understand, and hence to criticize, what is taking place. Once the Board and its staff become used to seeing substantive decisions take place in this procedural form, it is hardly surprising that they fail to see anything unusual, or improper, about casting a still more important substantive decision—that of the route moratorium—in the same procedural mold where it, too, is protected from judicial review, partly by the principle that the Board can control its own docket.[248]

If the difficulty of developing standards for determining which carrier shall receive which route is partly responsible for the Board's tendency to disregard procedural propriety, that tendency is not easily cured. The Board might, of course, decide to allow any "fit, willing and able" carrier to serve any route it chooses; the fact that it wishes to serve a route might be taken as evidence that it believes it can offer better service or lower prices. Or, the Board might take the offer of a lower price as a strong ground for awarding a route. The Board has done neither,[249] however. Once the decision is taken to restrict route awards beyond the "fit, willing and able" criterion, proceedings lengthen considerably and it becomes difficult to find a coherent set of standards that will not have the effect of restricting entry entirely.

Having rejected competition and lower fares as automatically desirable, the agency is tempted to forge standards out of its overriding instinct to protect existing carriers. And, since entry

[247] See Friendly, *The Administrative Agencies* (1959).

[248] Former Chairman Browne indicated, in his interview with the subcommittee staff, that he felt to have had a hearing on the wisdom on initiating a route moratorium would have risked a lengthy delay because of appeals to the courts.

[249] In only one case has the offer of a lower price been viewed as a positive reason for awarding a route; in several cases the Board has viewed such an offer as a *negative* feature. See notation 3320 at p. 22.

invariably threatens the profits of existing carriers, any such standards will be highly restrictive. Thus, the BOR's recent effort to codify route award standards has led to a set of criteria that would virtually end the awarding of new routes.[250]

In fact, before 1969, the Board awarded routes by giving different weight at different times to its desire to protect existing carrier revenues, its desire to build an efficient route network, its desire to supply the service requested by various cities and towns, and its desire somehow to even out carrier profitability. Given this broad range of rather abstract factors and many claimants, it is hardly surprising that a route case resembles an instance of political, rather than judicial, decisionmaking. Different sorts of arguments relating to different, and sometimes conflicting, standards are made by a host of claimants: existing carriers, cities, towns, new carriers, trade unions, airport representatives, and others. Proceedings last for years.[251] A decision finally emerges and that decision is written into an opinion, not by the Board itself, but by the Board's opinion writing section. The result is usually an opinion that lists a set of factors followed by the result.

Of course, it is difficult and dangerous to award such valuable commodities as routes through such a process. Yet, in fairness to the Board, it is equally difficult to see how coherent, consistent standards, readily applicable, can be created as long as the object is to administer a *restrictive* route policy. And, as long as these standards are not created, the temptation to use procedural short cuts and avoid full hearings on policy will be a strong one. Thus for procedural purposes as well as for reasons of policy, it is wise to examine the substantive wisdom of the Board's restrictive route award policies.

6. Substantive effects of the Board's route policy.

The Board's restrictive entry policy has had four basic effects—two arguably harmful to the traveling public and two arguably

[250] The Board's Bureau of Operating Rights recently proposed standards governing the setting of priorities or route hearings. In effect these standards, if adopted, would severely restrict, rather than liberalize, the Board's route policies. For example, the BOR proposes that no new route authority be given to any carrier for a route already served by other carriers unless the new carrier can show that its proposed operations will earn "at least a 12 percent return on investment in the first year." See BOR study at pp. 158–160.

This standard, and others that the report contains, were attacked by witnesses as overwhelmingly restrictive. The Airport Operators Council International testified that "the operation of competitive service in the first year simply cannot generate a 12 percent rate of return under reasonable circumstances. . . . No market will survive this test." Airport Operators Council International testimony. Lamar Muse of Southwest Airways stated that "there is no way that a carrier could make 12 percent return in the first year on a new route unless there are very unusual circumstances. We lost about 40 percent of our investment the first year or two while we were developing the market at these low fares. Now it is paying big dividends. I guess that (BOR standard) is one of their ways of barring new entry." Indeed, since no new carrier could earn much of a profit in its first two or three months, only by earning exorbitant profits toward the end of the year could a carrier average 12 percent.

Moreover, the study itself shows that there is no particularly good reason to bar new entry. The most conservative estimated increases in traffic-demand shows that traffic will increase from 137 billion passenger miles in 1975 to 201 billion in 1985, an increase of about 50 percent. The BOR estimates that 119 city-pairs not now being served with nonstop service will require such service between now and 1985. The overwhelming criticism of the BOR's proposals advanced at the hearing would provide cause for concern were it not for the fact that acting chairman O'Melia testified that the BOR proposals were, in effect, a dead letter, that they would probably "get shot out of the sky." In light of these assurances the subcommittee has not pressed its request that the Board study in detail the effect of the proposed BOR standards on probable future route awards.

[251] Compare the 3 months that it took the Texas Aeronautics Commission to process and to approve Southwest's application for entry into the Texas market with the 2–8 years required for similar proceedings before the Civil Aeronautics Board. Hearings at p. 1246.

Moreover, as Joan Holloway of the TAC's Carrier Regulation Division points out, despite the TAC's quick approval, "the CAB-certificated carriers were able to prolong the inauguration of service—through extended litigation—for a period of over 40 months after the application was first filed." It should also be noted that Southwest Airlines' recent application to serve Harlingen entailed an 18-month proceeding before the TAC—a proceeding "whose length resulted as much from dilatory tactics on the part of the CAB-certificated opponent as to certain procedural deficiencies in the Commission's Rules of Practice and Procedure which are in the process of being revised." (Letter to Senator Kennedy from Joan Holloway, July 15, 1975.)

beneficial. In the subcommittee's view, the harms considerably outweigh the benefits—a fact which suggests that a more liberal entry policy is desirable.

The basic issues parallel those discussed in section II above. Thus the four major affects of a restrictive entry policy will only be summarized very briefly here:

First there is strong evidence that the Board's restrictive entry policy has inhibited price competition, leading to higher fares and emptier aircraft, see section II, pp. 38–76, supra. In essence, a more flexible entry policy, allowing open entry for 20 years in California, has produced fares significantly lower than elsewhere. The Texas Aeronautics Commission's decision to allow a new route by Southwest Airlines has led to lower intrastate Texas fares. Charter carriers have kept fares on the North Atlantic at levels far below those which the scheduled carriers desire.[252] The very limited scheduled coach operations of the larger irregular carriers in the early fifties helped to bring about the introduction of low coach fares.[253]

There is every reason to believe that a less restrictive CAB entry policy would lead full-plane, low-fare carriers to enter new markets. The evidence that more open entry produces competitive pressures that bring about lower fares is considerable. Senator Kennedy asked Lamar Muse, the President of Southwest Airlines, "Would you like to fly outside of Texas?"

Mr. Muse. Well, if I did not have to come under the jurisdiction of the CAB I would. Yes. There are markets that really need service, like from Dallas to Tulsa, Dallas to Oklahoma City, Dallas to Kansas City. They are practically monopoly markets—markets that are not now served properly. We could really do a job on some of those markets. But, that crosses the Red River[254] [i.e. comes within the CAB's jurisdiction].

Mr. Guske of Pacific Southwest Airways was asked:

Senator Kennedy. Would you like to fly outside of California?

Mr. Guske. Yes, we would. We currently have pretty much been serving the major markets in California. There is not much left for us to expand into. As far as our future goes, we would be very interested in flying outside the state.[255]

Mr. Clifford, of Air California was asked:

Senator Kennedy. Do you think you could provide the same sort of inexpensive service outside of California?

Mr. Clifford. Yes, sir.[256]

Of course, other carriers would presumably enter new markets as well. As will be discussed at page 131 below, a more liberal entry policy will help the consumer only if the Board also allows airlines greater freedom to lower their prices. Then, increased pressure of entry would encourage existing carriers to lower fares and fill planes lest new entrants, offering fuller-plane, lower-fare service take away customers. In the longer run, carriers offering such service should survive in most markets, though others may withdraw. Without rate flexibility, however, freedom of entry would simply increase the level of excess capacity without producing lower prices.

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[252] Subcommittee on Administrative Practice and Procedure of the Senate Committee on the Judiciary, Procedures Relating to Minimum Charter Air Fares, 93d Cong., 2d sess. (staff report, 1974).

[253] See Caves, *Air Transport and its Regulators*, pp. 370–371.

[254] Hearings at p. 1248.

[255] Hearings at p. 445.

[256] Hearings at p. 447.

Second, as previously pointed out, the Board's entry policy has stabilized the shares of existing carriers. The industry today is made up, roughly speaking, of the same carriers in existence in 1938, each with a surprisingly similar market share. This stability guarantees that "(1) the grandfather trunk carriers enjoy security of route from outsiders, and (2) do not have to fear new entry by the extension of another certificated carrier based on price competition;" [257] it inhibits the spread of efficiency, for the more efficient carriers are not allowed to capture significant amounts of traffic from the less efficient; and it has tended to impede price competition.[258]

Third—on the positive side—the BOR study, the Keyes study, and the Library of Congress study all suggest that the Board, in administering its route policy in the fifties and sixties—prior to the "route moratorium"—made a serious effort to create efficient, integrated route networks.[259] This effort, however, was far from a total success. Despite efforts by the Board to eliminate irrational and wasteful restrictions contained in the carrier's route authorizations, many still exist. As previously mentioned, Pan American, for example, is forbidden to carry domestic passengers between New York and San Francisco despite the fact that it flies planes between these two cities anyway—as part of its international flight system. It is obviously wasteful—injuring both the air traveler and Pan American—to require Pan Am to turn away willing customers while its planes fly nearly empty. Similarly, the Board forbids Allegheny Airlines to fly nonstop between Indianapolis and Cleveland—it insists that Allegheny stop at Dayton—though Allegheny argues that many of its passengers would prefer nonstop service.[260]

Although building an efficient route network is obviously desirable, it's not clear why a restrictive entry policy is necessary to do so. If an integrated network is less expensive to sustain or if it better satisfies consumer desires, one would expect the revenues that it generates to cover its costs, producing incentives for carriers to build such networks even under competitive conditions.[261]

Fourth, the restrictive entry policies followed by the Board have undoubtedly prevented carrier bankruptcies. No major carrier has ever gone bankrupt. And, the 20-year period of open entry in California suggests that the competition engendered by such entry runs the risk of increased airline bankruptcy. Indeed, 16 small intrastate airlines left the intrastate airline business in California during that 20-year period, and of these several went bankrupt, leaving only two intrastate carriers.

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[257] Notation 3320 at p. 23.

[258] It may also be the case, as some witnesses argued, that a restrictive route policy encourages predatory behavior since limiting entry into a market makes it easier for a predator to recover the losses incurred in driving rivals out of business. See pp. 58–59, supra.

[259] Each of these studies are printed in the separately bound appendix to the hearings.

[260] Similarly, the CAB requires that all Allegheny flights from Cincinnati to Cleveland must make an intermediate stop in Dayton. Even though 25 percent of the Cincinnati to Cleveland passengers do not want to make the stop in Dayton, Allegheny cannot schedule a quarter of its flights to fly directly between the 2 end cities. Other wasteful route restrictions are not difficult to find. For instance, all Continental Airline flights originating from Seattle or Portland bound for Houston or New Orleans must complete the entire trip regardless of how many passengers there are on the second-half. If the traffic is particularly heavy on the Seattle to San Francisco leg, for instance, Continental cannot schedule an extra flight which flies only back and forth along that leg.

[261] A variation of this argument concedes that some protection from competition may be needed to encourage the development of an efficient integrated route structure, but once that structure is created, if it is less expensive to operate or better satisfies consumer desires, protection from competition is not needed to sustain it.

Undoubtedly, a bankruptcy works hardship on the carrier and its employees. It also may work hardship upon air travelers. For example, there is some evidence that a few of the bankrupt California airlines' passengers were not reimbursed for tickets already purchased. (When the largest air carrier, California Central Airlines, went bankrupt on February 14, 1955, it was charging $13.50 for round-trip service between Los Angeles and San Francisco. A passenger "stranded" by the bankruptcy might have had to pay between $30 and $50 for another ticket as well as an extra night's lodging.) On the other hand, the competition produced by these same intrastate carriers led to a significant extension of airline service to numerous small towns and satellite airports throughout California. And it led to a general fare level half as high as that elsewhere in the country.

Professor Jordan's study of the California experience includes a careful account of the effect of bankruptcies on service and affected passengers. He concludes that, although a number of carriers entered and exited the industry, service itself was stable, more extensive, and less expensive than it otherwise would have been.[262] Although the scheduled carriers have argued that a public outcry in California led to the enactment of laws that, since 1965, have restricted entry, Professor Jordan's research, including an analysis of newspaper articles of the period, indicates there was no such outcry. Rather, entry restrictions seem to have been enacted without much publicity and with the tacit approval of the existing major carriers.[263] Of course, exit from the industry need not take place through bankruptcy. The CAB has demonstrated over the years that it is often possible to arrange for mergers between failing carriers and others and thereby to protect to some extent the interests of employees and shareholders.[264]

In essence the witnesses from the executive branch, the Federal Trade Commission and independent experts argued that entry liberalization would be a fair policy, for it would enable firms not now in the industry to have an opportunity to enter; it would benefit the consumer, for entering firms would provide pressure for lower fares and better service. The major carriers and the Board argued that more liberal entry threatens industry stability. The smaller scheduled carriers, supplemental carriers, and the Airport Operators Council International supported the critics insofar as they favored an entry policy that is liberalized, but not totally open. For reasons set out above, the subcommittee believes that a more open entry policy is highly desirable.[265]

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[262] See supplementary testimony of William A. Jordan. Hearings at pp. 601–17.

[263] Professor Jordan writes, "My own intensive study of the California intrastate carriers began in Jan. 1965, yet I was unaware of the state legislature's plan to increase the PUC's jurisdiction over intrastate passenger airlines until my first visit to the PUC's offices in early March 1965. At that time a PUC official (John L. Pearson) advised me that assembly bill 413 was being considered, and, when I asked why this was happening after so many years of unregulated service, his reply was to the effect that this time PSA supported the legislation. If there were a public outcry favoring regulation, one would expect it to be reflected in newspaper articles of that period. In the course of my research I went through the clipping files of the Los Angeles Times and the San Diego Tribune looking for information concerning intrastate carriers. Nowhere in those files did I come across an article containing statements from passengers (or others) complaining about intrastate carrier service and asking for airline regulation. Mr. Mitchell (of Continental Airlines) may be able to supply contrary evidence, but until he does my experience led me to believe that assembly bill 413 was enacted with little publicity, let alone public outcry." A similar bill had been proposed in 1949 but, strong criticism of the bill prevented its enactment. The Burbank Daily Review, for example, characterized the bill as one "clearly in the interest of 'protecting' the public from low cost air transportation." It concluded that "any casual onlooker * * * ought to be disgusted by the series of attempts made to hamstring air progress." This type of press reaction, together with the opposition of PSA and the other intrastate lines in 1949, was sufficient to defeat the bill. If Professor Jordan is correct, PSA's change of position after it had become the dominant State carrier led to the enactment of the bill. Whether PSA has benefited from PUC regulation is highly debatable. See PSA's comments on subcommittee draft report, pp. 3, 8–9.

[264] Of the 17 original trunkline carriers 7 have exited the industry through merger; of the original 21 local service carriers, 12 have exited the industry through merger.

[265] Pp. 38–76, supra.

7. Conclusions.

On the basis of the evidence submitted to it, the subcommittee believes that the Board's procedures are defective and should be modified in the following ways:

a. Procedural Change

(1) The procedures used by the Board to formulate and to administer its route moratorium should be abandoned. Major shifts in Board policy should not be determined or announced through informal meetings, speeches to the industry, private staff discussions, and decisions in particular, individual cases, without providing an opportunity for members of the industry and of the general public affected by such a policy to submit their views to the Board prior to the policy's formulation. Rather, the Board should actively seek statements of position, proofs, and arguments related to proposed changes in general policy before the Board makes up its mind. And, such statements should also be open to the public so that each party can comment upon the statements of others.

Rulemaking proceedings of this kind need not be unwieldy, for the Administrative Procedure Act gives the Board adequate power to tailor the scope of the proceeding to the purpose at hand. And even though the Board is required to publish all statements of general policy or interpretations of general applicability,[266] rulemaking proceedings need not precede the adoption of any such statement or interpretation. Rather, when the Board is considering an important and significant change in an important policy, it should do so only after giving the public an opportunity to express its views about such a change in an open forum. Unless the Board makes a conscious effort to administer such a procedural policy in good faith, it risks a recurrence of its unfortunate experience with the route moratorium. And, as the subcommittee discovered, the closed procedures and disingenuous manner in which that policy was created and put into effect led to the adoption of an unwise policy and to a considerable loss of public confidence in the agency.

(2) The Board, in route cases, should abandon the use of a procedural motion—the motion for an expedited hearing—to set substantive policy. It should, instead, develop a summary judgment procedure under which it either dismisses a case outright as unwarranted or proceeds in the ordinary course of affairs to hold a hearing on the application. Priority among applications which survive a summary judgment procedure should not be determined on the basis of an estimate of the relative strength of the application. Rather, the Board should develop neutral criteria such as first-come-first-served, tempered by numerical estimates of the size of the potential market and the number of carriers currently serving it.

(3) The Board should revise its standards governing ex parte communications. At present the Board's rules forbid only ex parte communications that concern matters that are already the subject of agency adjudicatory proceedings.[267] Yet, as the subcommittee found in its hearing on minimum charter rates last November and

[266] 5 U.S.C. sec. 552(a)(1)(D).
[267] See 14 C.F.R. sec. 300.2(a)(1974).

documented in its report on those hearings, policy positions are often formulated by the Board prior to the Board's announcement that it intends to hold rulemaking or adjudicatory hearings. In other words, the Board has in some major instances made up its mind first and held hearings later. This fact, taken together with the large number of private meetings between industry members and the Board, has severely shaken public confidence in the impartiality and fairness of the agency's actions.

Any change in ex parte communications standards should take place in two directions. First, the definition of ex parte communications should be tightened so that it includes not simply the matters that are currently the subject of agency proceedings, but also matters which the Board member believes are *likely to become* the subject of such proceedings within the subsequent 6–12 months. Second, at the same time, the ex parte communication rules should be liberalized so that they do not *forbid* all such communications. Rather, the rule governing the communication should be tailored to the type of communication at issue. Thus, for example, all communications related to an actual adjudicatory proceeding should be forbidden. Communications related to a possible rulemaking proceedings, however, need not be forbidden; rather, they might be transcribed and made available to the public. Or each Board member might be given the full power in his own discretion to distinguish between significant and insignificant communications, fully transcribing the former, while simply noting that the latter have occurred. Finally, all private meetings with industry members or other private parties might simply be noted and summarized in a log, which is publicly filed.[268]

The exact details of changed rules must be worked out by the agency in light of its particular problems. Yet, the subcommittee feels that the substitution of this type of "spectrum" approach to the problem of ex parte communications is preferable to the present rule which absolutely forbids one significant subset of all private communications while not controlling others at all.

(4) The Board should develop a strict set of time limits applicable to route applications. The fact that route applications in Texas can be processed within a 3-month period, while similar applications pending before the Board take several years, suggests that the Board both can and should speed its route award proceedings. The subcommittee expects the Board to develop and promulgate a set of standards designed to do just that.

b. Substantive Changes

The subcommittee also believes, on the basis of the record before it, that substantive change in CAB route policy is warranted. The logic of the procompetitive argument—that the threat of potential entry will police and discipline the market behavior of existing firms and ensure the lower prices and improved service that consumers desire—is strong. And practical experience with liberalized entry, in California and Texas, and elsewhere, suggests that more open entry will work to the consumers' benefit. Compared with this experience and these arguments, the concerns of the carriers, while important, seem more speculative than real.

[268] See notes 244 and 245, supra.

On the other hand, suddenly to bring about open entry at a time of excess capacity runs the risk of severely injuring existing carriers before they have a chance to adjust to new market circumstances. The existing carriers have undoubtedly relied upon the existing regulatory framework in developing their businesses and expanding their service. Their employees and managers are used to the present system and may be uncertain how to work within a new one. Thus, both for reasons of fairness and efficiency, it is desirable to implement a shift from a protective, to a competitive, entry policy slowly. Moreover, slow implementation of such a policy will provide opportunity to observe its effects. Thus, if the carriers' fears of chaos, or the ending of service to small- and medium-sized communities, should prove warranted, these tendencies will appear sufficiently soon for the Board and Congress to pull back.

Thus, while the subcommittee endorses an open-entry policy as a future goal, it believes that the Board and Congress must proceed in a more competitive direction in a series of measured steps.

The subcommittee recommends the following changes:

1. The Board should reject the route award standards proposed in the BOR study discussed in note 250, supra.

2. The Board should ratify the testimony of Acting Chairman O'Melia by announcing that the route moratorium is at an end and that hearings will be provided those carriers proposing fuller-plane, low-fare service.[269]

3. The Board should develop a measured program that gradually liberalizes entry into the industry, with the object of promoting rate competition. (This program would accompany the Board's present policy of allowing airlines to discontinue unprofitable service provided adequate substitute service by commuter carriers or others is made available.) Such a program might consist of one or more of the following elements:

(a) The Board would immediately begin to weigh a carrier's offer of lower rates as a very important factor *in favor* of granting a route application.

(b) The Board would immediately begin to allow existing carriers to remove route restrictions. To eliminate waste, carriers would be granted "fill-up" rights on route segments that they already fly. As a step toward liberalizing entry, for example, carriers might also be allowed to fly nonstop over segments that they now fly one-stop.

The procedure used as part of a liberalized route award policy is of great importance. The subcommittee suggests the use of strict time limits and a shifting of the burden of proof onto those who would oppose the awarding of an application. For example a carrier wishing to remove a restriction would have to show only that it is "fit, willing and able" to fly the unrestricted route. The Board would be required to make this determination within six months[270] of the application. Moreover, prior to 6 months, the Board would be allowed to deny a request to remove a restriction only upon a determination that its removal would "seriously impair the availability of air service on the affected route." After 6 months, if the Board had not concluded the proceeding, it would be required to award the carrier a "provisional" certificate without the restriction; that certificate would automat-

[269] See Hearings at p. 649.

[270] Time limits could be extended by the Board if it finds that the applying carrier has been deliberately dilatory in order to force expiration of the time limit and this automatic award of the route.

ically become permanent within nine additional months unless the Board found "by clear and convincing evidence" that the award "had severely impaired the availability of service on the affected route."

(c) The Board would immediately liberalize its charter rules as suggested at pages 133–34, infra. Part charters should also be considered by the Board.

(d) If the first three steps (a–c, above) worked reasonably well, the Board might, after an appropriate period proceed further by allowing existing certificated carriers to fly any route segments that connect with their present route segments, upon a showing that they are "fit, willing and able" to provide such service. The procedure followed would be that outlined in (b) above.

(e) The Board might, after a further period of time, allow any supplemental carrier to offer scheduled service on any such route upon a showing that it was "fit, willing and able" to provide service. Again, the procedure followed would be that outlined in (b) above.

(f) If the above five steps worked reasonably well, the Board could, allow any firm wishing to supply air service on any route to do so provided that it demonstrated that it is "fit, willing and able" to do so. The procedure followed would be that outlined in (b) above.

These recommendations are meant to suggest a possible step-by-step program moving towards open entry. The Board could pull back from such a program if, after a reasonable period of time, it determined that the quality of air service was seriously threatened. Similarly, if Congress mandates such a program legislatively, it could retain the option, through concurrent resolution, of slowing down or terminating the experiment should serious threats to the quality of air service appear.

B. RATE POLICY

The Board has recently completed an elaborate set of proceedings, begun in 1970, designed to develop a set of rules and standards governing the setting of rates. Those proceedings—the Domestic Passenger Fare Investigation (DPFI)—codified many practices followed by the Board prior to 1970. They determined most of the practices followed during the early seventies, and they specified the rate-setting practices to be followed in the future.

This part will evaluate those practices. Section 1 will briefly describe the statutory background and several of the procedural problems that led the Board to institute the DPFI. Section 2 will describe the standards that have emerged from the DPFI and that have been used by the Board to set rates for the past few years. Section 3 will evaluate those standards and practices.

Basically, the subcommittee has concluded that, despite improvements compared with previous practice, they have produced fares that are too high; at the same time they are incapable of dealing with the problems of industry inefficiency or inadequate profits. These results reflect the impossibility of devising an automatic, administrable rate-setting system that can regulate a highly competitive industry operating in an economically volatile environment. Section 4 will consider the major alternatives to the present system, setting out the subcommittee's conclusion that the Board ought to institute a more flexible rate system that allows the carriers, within a Board-set ceiling, wide latitude to set their own fares.

1. Background.

The Board's basic power to control rates arises from the law's requirement that certificated carriers file tariffs with the Board specifying the rates that will be charged.[271] If the Board believes that a rate embodied in a tariff may be unjust, unreasonable, or discriminatory, it can suspend that rate for 6 months while it holds a hearing to determine whether its suspicion is well founded.[272]

As a practical matter, a full-fledged hearing after a tariff suspension is unusual, for carriers are not often willing to bear the expense involved; thus, they frequently simply file a new tariff with a different rate. Conversely, if the Board decides not to suspend a tariff, it is difficult, if not impossible, for consumer groups to attack the reasonableness of the rate in court.[273]

The Board also has the power to initiate a rate investigation on its own, and to determine and set those rates that it finds to be just and reasonable.[274] This power was used to institute the DPFI, but it has not often been exercised.

In determining whether a tariff is just and reasonable, the Board, among other criteria, applies five statutory standards. The two most relevant for present purposes require the Board to consider (1) "the need for adequate and efficient transportation . . . at the lowest cost consistent with the furnishing of such service," and (2) "the need of each air carrier for revenue sufficient to enable such air carrier under honest, economical and efficient management to provide adequate and efficient air carrier service." [275] Thus, the Board is told to set low fares for consumers, to obtain efficient service for travelers and communities, and to provide reasonable profits for air carriers.

It is nearly impossible [276] to develop a coherent regulatory procedure that applies these general standards to the aviation industry because of four basic facts: 1) The industry is composed of different carriers, each with a different system, different costs and different revenues. 2) The industry is highly competitive and perfectly willing

[271] FAA sec. 403.

[272] FAA sec. 1002(g), 49 U.S.C. 1482(g) (1970), which provides in full:

(g) Whenever any air carrier shall file with the Board a tariff stating a new individual or joint (between air carriers) rate, fare, or charge for interstate or overseas air transportation or any classification, rule, regulation, or practice affecting such rate, fare, or charge, or the value of the service thereunder, the Board is empowered, upon complaint or upon its own initiative, at once, and, if it so orders, without answer or other formal pleading by the air carrier, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, fare, or charge, or such classification, rule, regulation, or practice; and pending such hearing and the decision thereon, the Board, by filing with such tariff, and delivering to the air carrier affected thereby, a statement in writing of its reasons for such suspension, may suspend the operation of such tariff and defer the use of such rate, fare, or charge, or such classification, rule, regulation, or practice, for a period of 90 days, and, if the proceeding has not been concluded and a final order made within such period, the Board may, from time to time, extend the period of suspension, but not for a longer period in the aggregate than 180 days beyond the time when such tariff would otherwise go into effect; and, after hearing, whether completed before or after the rate, fare, charge, classification, rule, regulation, or practice goes into effect, the Board may make such order with reference thereto as would be proper in a proceeding instituted after such rate, fare, charge, classification, rule, regulation, or practice had become effective. If the proceeding has not been concluded and an order made within the period of suspension, the proposed rate, fare, charge, classification, rule, regulation, or practice shall go into effect at the end of such period: *Provided*, That this subsection shall not apply to any initial tariff filed by any air carrier.

[273] See, R. S. Spritzer, "Uses of the Summary Power to Suspend Rates: An Examination of Federal Regulatory Practices," 120 U. Pa. L. Rev. 39 (1971).

[274] FAA sec. 1002(e)(5).

[275] FAA sec. 1002(c). The others include "the effect of such rates upon the movement of traffic . . . such standards respecting the character and quality of service to be rendered by air carriers as may be prescribed by or pursuant to law . . . (and) the advantages of transportation by aircraft."

[276] It may be, as the Justice Department stated, that the need for regulation of air fares "has not been rigorously analyzed but has been assumed to be necessary solely because Government oversight of prices in transportation has been traditional." Hearings at p. 1204.

to substitute service for price competition. 3) The industry faces continuously changing cost and demand conditions.[277] 4) In part, because of the first three facts, rate hearings involve many parties; they are complicated and lengthy.

During the 1960's [278] the Board tried to deal with the first of the problems by stating that it would base its determination of a reasonable fare on average industry cost. Fares would allow the industry taken as a whole to recover its costs including a reasonable rate of return.

The third and fourth problems were less important then, for costs were falling, demand was rising, and there was, therefore, little pressure from the airlines to increase prices. In general, the companies did not ask for rate increases; the Board did not compel them to cut fares; price reductions took the form of discount plans. Thus in the 1960's regular fares stayed fairly constant, and fares considered as a whole fell less rapidly than did costs.[279] (See table 14) Since demand grew as well industry profits in the mid-1960's were high; the airlines realized their three most profitable years out of the last 20 (see table 15). (Trunkline return on investment 1964 was 9.6 percent; in 1965, 12.2 percent; in 1966, 10.9 percent.) The carriers, however, soon began to add capacity, load factors began to decline, and costs rose to meet revenues. (Note the gradual decline in trunkline load factors shown in table 16.)

Why, in the 1960's did the airlines compete through scheduling and service? [280] Why did they not also compete by cutting general fare levels?

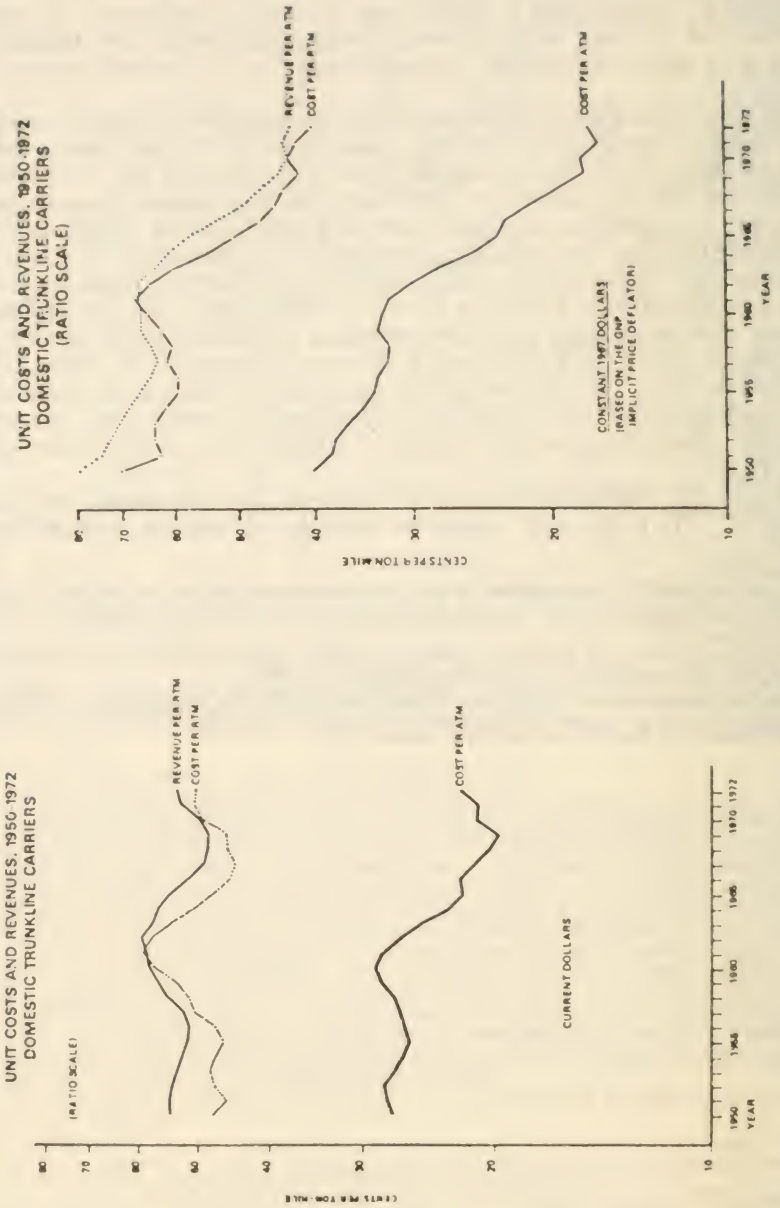
[277] Demand, for example, is highly cyclical. Changes in demand are associated very strongly with changes in disposable personal income; thus over a 2 or 3 year period the rate of growth in air traffic can change considerably. See Hearings at p. 2244 (statement of Herbert Moser, vice president, Merrill Lynch, Pierce, Fenner & Smith).

[278] For an excellent account of the Board's route and rate policies and the effects of those policies in the 1950's and early 1960's, see Caves, *Air Transport and Its Regulators* (1966).

[279] See BOR study at p. 27. Yield in constant dollars fell in every year since 1950, as did cost. During the early 1960's cost fell more rapidly than revenue. Notation 3320 states at p. 26; during the 1960's "although yields did tend to decline . . . the relative decline in prices was not equal to the decline in cost."

[280] See Fruhan, "The Fight for Competitive Advantage" (1973).

TABLE 14



Source: BOR study at 26.

TABLE 15.—RATE OF RETURN ON INVESTMENT, TRUCKLINE AND LOCAL SERVICE CARRIERS[1]

Year	Truckline	Local service	Year	Truckline	Local service
1947	−4.65	−15.27	1961	1.00	11.05
1948	2.65	−1.06	1962	3.72	11.04
1949	5.91	−.40	1963	4.02	8.88
1950	12.09	−6.55	1964	9.62	10.08
1951	13.44	12.77	1965	12.21	11.43
1952	14.19	.35	1966	10.87	7.46
1953	11.22	−2.22	1967	7.74	2.70
1954	11.21	13.47	1968	5.34	−.39
1955	11.85	7.48	1969	4.93	−4.43
1956	9.57	−.32	1970	1.59	−3.93
1957	4.80	−2.62	1971	3.84	4.98
1958	6.49	9.64	1972	6.22	9.63
1959	7.12	4.95	1973	5.90	9.0
1960	2.79	9.12	1974	9.25	12.2

[1] 1965–70 rate of return on adjusted investment excluding investment tax. 1971–72 based on regulatory investment

Source: "Handbook of Airline Statistics," 1971 edition. pt. II, table 68 and pt. VI, table 1a. Data for 1971 and 1972 from financial and traffic data section, B-48B.

Source: BOR study and CAB.

TABLE 16.—REVENUE PASSENGER LOAD FACTORS IN CALIFORNIA AND UNDER CAB REGULATION

Year	Domestic trunks	California airlines	Year	Domestic trunks	California airlines
1945	88.2		1959	61.4	71.1
1946	78.8		1960	59.5	71.1
1947	65.7		1961	56.2	72.1
1948	58.5		1962	53.3	75.3
1949	59.1		1963	53.8	72.8
1950	62.7		1964	55.4	
1951	69.6	69.0	1965	55.2	74.9
1952	67.1	65.9	1966	58.5	63.3
1953	64.7	67.1	1967	57.2	N.A.
1954	63.4	69.2	1968	53.0	N.A.
1955	64.1	72.2	1969	49.9	N.A.
1956	64.1	75.7	1970	49.1	N.A.
1957	61.5	80.6	1971	52.1	N.A.
1958	60.0	72.9	1972	53.5	N.A.

Source: CAB, "The Domestic Route System," a staff study by Bureau of Operating Rights, appendix B, table 9 (Oct. 1974); and Jordan, "Airline Regulation in America," at p. 202 (1970).

The Board argues that the industry is too concentrated to engage in price competition; without regulation the "oligopolist" airlines would raise prices, not lower them.

The Department of Transportation, the Department of Justice, the Council of Economic Advisers, and others claimed to the contrary that Board restrictions on entry are largely responsible, for they inhibit the competitive pressure that would otherwise force price competition. Moreover, they claimed that the Board's rate setting system also inhibited price competition: the statutes require a carrier to announce a new lower rate at least 30 days in advance. Competitors are thus alerted, and they can appear before the Board attacking any proposed fare cut as unreasonably low, discriminatorily preferential, prejudicial, or unfairly competitive. The Board may then suspend the proposal, costing the carrier whatever money it has spent promoting its new fare, and forcing it into costly Board litigation. According to some witnesses price cutting is unusual, in part because the Board frequently suspends tariffs embodying cuts, embroiling the price cutter in litigation. [281] A witness for Continental Airlines stated "you

[281] See Hearings at pp. 59–73 (prepared statement of Gary L. Seevers and James C. Miller, III); p. 438 (statement of George Douglas); p. 583 (statement of Harvey Wexler, Continental Airlines).

find the same kind of stickiness in the Board's process if you are attempting to reduce the fare that you would if you wanted to raise it." [282]

Toward the end of the sixties the major issues before the Board concerned price increases. The Board seemed to handle these matters "informally." Board members and representatives of the carriers would talk to each other either directly or by using members of the Board's staff as intermediaries to communicate views and positions between the Board and carrier representatives. Thus, one carrier representative testified that "there has been in the past a kind of informal communication between carriers and the Board's staff about what was going to be expected." [283] And, one highly knowledgable Washington lawyer added:

> It is true that carriers do try informally, and have for years, to get a sense of what the Board will approve. The problem is that if they don't they get suspensions and investigations rather than fare increases . . . if every carrier filed a different (fare) number independently, . . . the Board . . . would almost be forced to suspend all of them and investigate them. . . . if they waited for the formal process to take effect where the Board initiates an investigation and suspends carrier tariffs and investigates then it would be 2 years before you got your fare increase, and you really would go down the drain. [284]

He went on to say that:

> There was a practice that grew up at one time in which particular carriers would come in and have private meetings with the entire Board and would make a pitch. And, sometimes the ATA came in and had its private meeting with the Board and made a pitch and discussed their problems and aspirations and so forth. And, it was a process that at least had a great potential for abuse because it was a total ex parte communication. Just because it was an elegantly produced one, it didn't prevent it being an opportunity for making comments on pending applications or pending positions on policy.[285]

These informal procedures obviously allowed the Board to adjust its rate policy rapidly to changing economic conditions, but the price paid in terms of elementary procedural fairness was a high one. Thus, "two members of the Board . . . . insisted that the practice be modified," [286] and one especially flagrant example of this practice was held unlawful in *Moss* v. *Civil Aeronautics Board*.[287]

After the Board was legally forbidden to set rates through informal negotiation and consultation, it embarked upon a set of hearings designed to produce a more satisfactory fare setting system. This investigation—the Domestic Passenger Fare Investigation (DPFI)—lasted nearly 5 years.[288] It led to the adoption of an elaborate set of pricing rules, which worked nearly automatically and were thought to overcome the need for informal communication. They were designed to keep abreast of changing economic conditions, while, at the same time, obviating the need for continuous lengthy hearings. For the most part, the subcommittee heard testimony about past effect and the likely future effect of implementing this eleborate system of rate rules.

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[282] Hearings at p. 3122.
[283] Hearings at p. 1225 (testimony of Thomas Finney, counsel, Continental Airlines).
[284] Hearings at p. 1226 (testimony of Lee Hydeman, counsel, Continental Airlines).
[285] Hearings at p. 1228.
[286] Hearings at p. 1228.
[287] 430 F.2d 891, (D.C. Cir. 1970). The court held unlawful certain tariffs which the carriers had filed in close conformance to a CAB order outlining what fares would be acceptable. The court held that these fares were, in effect, fares set by the CAB without the required public hearings.
[288] It began Jan. 29, 1970, CAB Order 70-1-147 and concluded Dec. 27, 1974, CAB Order 74-12-109.

2. The Board's present ratesetting system.

To understand what is wrong with the Board's ratesetting system, it is first necessary to understand that complex system in some detail. The Board's ratesetting rules and standards represent a serious effort to tailor classical ratemaking principles to the special needs of the aviation industry. Classical ratemaking is normally used to set the rates of a regulated monopolist, such as an electricity company. It seeks to set rates at a level where they will cover costs and attract investment sufficient to provide adequate services. In broad outline, classical ratemaking works as follows:

(1) The regulator takes a test year, say, 1974.

(2) The regulator adds the firm's operating costs, depreciation, and taxes for that year.

(3) The regulator adds to that sum a "reasonable profit." The reasonable profit is determined by multiplying a "reasonable rate of return" times a "rate base." [289]

The total so far—the sum of operating expenses, depreciation, taxes, and a reasonable profit—equals the firm's "revenue requirement."

(4) The regulator sets prices so as to produce revenue for the firm equal to the firm's "revenue requirement." [290]

(5) If the firm sells several different services, or serves different sorts of customers, the regulator may also determine the firm's "rate structure." That is to say, the regulator may set the precise proportions in which the company is to obtain its needed revenue from different classes of customers.

The Board's system, in a very rough way, follows the classical outline: The Board determines the carrier's "revenue requirement." It then sets rates at a level designed to yield that "revenue requirement." The Board, however, has made two very important modifications in the classical system. First, the Board sets rates on the basis of average industry costs. It determines a "revenue requirement" not for each individual carrier, but for the industry as a whole. Second, the Board now sets "load factor" (and other) standards prerequisite to applying the formula to an individual carrier.

The Board had been urged to set load factor standards as a way of overcoming the problem of the "ratchet effect." The "ratchet" went to work once the Board set fare levels designed to earn the carriers a fairly good profit. It was claimed that the carriers would then engage in extensive service and scheduling competition. The carriers would thereby raise their costs and lower their profits. They would then go back to the Board and obtain a fare increase, pointing to their low profits as justification. The whole process would then begin again. In principle, the ratchet could work indefinitely producing nearly empty planes and skyhigh fares.[291]

The use of a "load factor" standard is supposed to inhibit the working of the ratchet by determining the industry's "revenue requirement" on the basis of what industry costs and revenues would have

[289] A "reasonable rate of return" is determined by looking at the firm's interest payments on its debt, estimating a reasonable return to equity, and weighing the two in accordance with the firm's debt/equity ratio. The "rate base" is determined by subtracting from the total investment made by the firm in plant, equipment, etc., the total amount that has been recouped through depreciation.

[290] The regulator typically determines what fare level is needed by dividing the "revenue requirement" by the firm's output in the test year. The result is a price level which, when multiplied times output, yields the "revenue requirement." Of course, such an approach takes no account of the fact that a change in the price level may itself change the firm's output, thus, changing the total amount of revenue that is yielded.

[291] See Douglas and Miller, note 36, supra, ch. 4.

been had the industry, on average, flown its planes reasonably full—full to the level set in the standard. The Board currently uses a 55-percent load-factor standard. In the DPFI the Board set not only a "load factor" standard, but also standards governing seating configurations, the use of discount fares, an appropriate rate of return, and an appropriate measure of "demand elasticity." [292] Many of these standards were designed to stop excess service competition.

Thus, the Board's determination of the industries "revenue requirement" now works roughly as follows:

(1) Every 3 months the domestic carriers submit full domestic (50-state) cost and revenue figures to the Board's Bureau of Economics. The Bureau separates out figures related to the 48 continental States.[293]

(2) The Bureau then adjusts the figures for the previous 12 months in the following ways:

First, it applies the 55-percent load-factor standard. It does so by refusing to count industry costs insofar as they arise from the flying of extra empty seats. If, for example, the industry has flown actual passengers 55 billion revenue passenger-miles, the Bureau will allow costs necessary to carry total seats 100 billion available seat-miles (55 billion rpm/100 billion asm×55 percent). If the industry has, in fact, carried seats for 110 billion available seat-miles, the Bureau will deduct from industry costs the cost of carrying seats the extra 10 billion seat-miles.[294]

Second, the Board makes a similar adjustment insofar as the industry has flown planes with too few seats or seats that were not sufficiently close together (coach seats in many planes, for example, are supposed to have a 34′ pitch and seat six abreast; first-class seats are to have a 38–40′ pitch and seat four abreast).

Third, the Bureau adjusts for discount fares. The object of this adjustment is to discourage the industry from moving traffic at discounts that may have the effect of requiring the standard fare passenger to subsidize the low-fare passenger.[295] Thus, the Bureau adjusts revenues on the assumption that all traffic moved on regular fares. The Bureau estimates how many passengers carried at discount fares would have flown anyway. It assumes that these passengers paid regular fares, and it increases the industry's revenue figures to reflect the extra amount that these passengers would have paid had they paid full fare. It then estimates how many passengers paying the discount fare would not have flown but for the discount. The fares that these passengers paid are subtracted from industry revenue.[296]

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[292] Id., ch. 8.

[293] The 50-state figures and the Bureau's process for deriving 48-state figures from them appear to be confidential. It is unclear why this information is not public.

[294] The Bureau figures the cost of the extra 10 billion seat-miles as follows: (1) It takes the several separate cost items: aircraft operating costs, capital costs, and tax costs. (2) It divides each of these costs by the total number of seat-miles flown in the industry, thus obtaining a figure for average operating cost per seat-mile, average capital cost per seat-mile, and average taxes per seat-mile. (3) It assumes that 65 percent of the aircraft operating costs are associated with the number of seat-miles carried; that 75 percent of the capital costs are associated with the number of seat-miles carried; and that 75 percent of tax costs are associated with the number of seat-miles carried. (4) (a) It takes 65 percent of the average operating cost per seat-mile and multiplies it by the number of extra seat-miles flown; (b) it takes 75 percent of the average capital cost per seat-mile and multiplies it by the number of extra seat-miles flown, and (c) it takes 75 percent of the average tax cost per seat-mile and multiplies it by the number of extra seat-miles flown. (5) It adds together these results, which represent the extra cost of flying too many seat-miles, and subtracts these from the industry's cost figures.

[295] See pp. 134–40, infra.

[296] Assuming that the discount was rational—that is to say, assuming that the discount generated more revenue by adding new passengers than it lost by carrying old passengers at reduced rates—the effect of this adjustment will be to lower industry revenues thus understating industry profits. Thus, this adjustment alone will not discourage the use of discount fares; but, since the Board also removes the costs that it associates with the carriage of the extra discount passengers (and since these costs are greater than the incremental costs actually incurred) its resulting cost figures will also understate costs. On balance, the adjustment may overstate profits and discourage the use of discount fares.

Fourth, as a result of the discount fare adjustment, the Bureau now assumes that the number of passengers carried is less than the industry states (traffic generated by the discount has been removed). The Bureau then recalculates the "load factor" adjustment in order to allow the industry only those costs associated with a 55-percent factor; it removes from the industry cost figures costs associated with what are now more "extra"seats.

(3) At this point, adjusted costs are subtracted from adjusted revenues. The remainder is "return on investment" or "profit." If return on investment is less than 12 percent of the industry's "rate base," the carriers are "entitled" to a fare increase. Before determining whether the carriers are still entitled to a fare increase, however, the Bureau makes another adjustment designed to bring figures up to date. It does so by (a) annualizing the industry's costs; (b) annualizing the industry's revenues; and (c) annualizing industry investment. The Bureau "annualizes" by calculating the cost, revenue, and investment figures for the entire year on the basis of what they were at the end of the year, which may be higher than the average figure for the prior year. Thus, fare increases granted during the year, or cost increases incurred during the year, will be assumed to have extended throughout the entire year. After this annualization, if subtracting costs from revenues leaves a remaining sum which provides a return on investment of less than 12 percent, the industry is automatically entitled to a fare increase sufficient to raise returns to the 12 percent level.

(4) The amount of the fare increase to be allowed is determined on the assumption that the "elasticity of demand" equals −0.7. That is to say, a 10-percent increase in fares will cause a 7-percent decline in traffic. To generate extra profits fares must go up high enough to take the effect of declining traffic into account.[297]

Once it is determined by what percentage industry fares will be allowed to increase, every carrier in the industry is allowed to file tariffs that embody that percentage increase, whether or not the individual carrier was losing money. More-efficient-than-average carriers will thus be allowed to earn more than 12 percent; carriers of less than average efficiency will still be condemned to earning less than 12 percent; and, the industry, on average, will earn 12 percent.

(5) The above was used to determine the industry's revenue requirement. In a different part of the DPFI, the Board set rules governing the industry's rate structure—the level at which individual rates should be set in order to generate the industry's revenue requirement. The Board determined that equal fares would be charged for trips of equal mileage. Each fare would be calculated by setting a fixed sum of $13.85 terminal charge and then adding to that figure a sum of a few cents per mile. The mileage charge for short trips is higher than for long trips, for, in the Board's view, shorter trips, in general, are more expensive per mile to fly. Thus, the mileage charge is 7.79 cents per mile for trips insofar as they are under 500 miles, 5.94 cents per mile for trips insofar as they are between 500 and 1,500 miles, and 5.71 cents per mile for trips insofar as they extend

[297] Thus, for example, if industry profits as determined by the Board's formula will equal only 8 perecnt for the next year, the industry is entitled to a 4-percent increase in profit. But, because price increases will reduce demand for air travel, it will take a greater percentage fare increase to generate sufficien trevenues to leave the industry, after adjustments, a 12 percent return. Since declines in revenue due to lost traffic are offset, to a considerable extent, under the CAB's standards, by a decline in recognized costs, the assumption of inelastic demand, by itself, may not raise fares significantly.

beyond 1,500 miles.[298] In principle the sum of all fares calculated through the use of this formula should just equal the industries revenue requirement calculated by means of steps 1–4 above.

(6) The airlines submit cost figures to the Board every 3 months. Those figures provide information about costs, seats flown, and passengers carried for the preceding quarter. Every 3 months the Board, within a few weeks time, uses those figures to calculate industry costs, revenues, and profits for the preceding year, which it then publishes. By making the calculations described in steps 1–5, the carriers, and the Board, can immediately determine whether a fare increase is called for. If so, carriers may immediately file for an increase, as they did in November 1974. Opponents of the increase may file arguments in response, but if the figures have been calculated properly, *there will not be much to argue about.* Thus, despite differences of opinion about a number of matters—such as whether discount fares were treated properly in the calculation—the Board allowed the carrier request for a fare increase in November 1974 to take effect *without a hearing.*

The net result was the creation of a system that improved prior practice in many ways and, from a purely administrative point of view, has much to recommend it. The DPFI formula determine, from the carriers' cost figures, submitted to the Board every 3 months, and from the use of mechanical formula, just how much revenue the industry needs and what relation individual fares should bear to each other. They thus show automatically how individual fares can be adjusted to produce the needed revenue. Through the use of its tariff suspension power, the Board can make this system operate automatically. It stated:

> *We will require* the carriers for the present to file *coach fares using the formula we have adopted.* Tariffs which change coach fares in individual markets and which are based on a formula which is farther from the cost curve—setting the proper relation between fares for routes of different mileage—at any distance will be rejected.[299]

Thus, the Board seemingly can set and adjust fares almost automatically without lengthy hearings on the one hand or ex parte, informal contracts on the other.

What then has gone wrong? Why has this remarkable system produced fares that are nearly twice as high as those in California or Texas for comparable routes? Why are fares 40 percent higher than cost estimates submitted by Lockheed and Boeing? Why are they double charter rates? Why, at a time of falling demand, have fares been increasing? The next section will discuss a number of defects inherent in the Board's ratesetting processes that have helped to bring about these undesirable results.

3. The effect of the Board's ratesetting procedures.

The subcommittee's doubts about the effectiveness of the Board's rate standards and procedures initially arose from the fact that the Board approved domestic fare increases totaling about 20 percent

[298] Originally in phase 9 the Board set a basic charge of $12 plus 6.75 cents a mile for short lengths, 5.15 cents a mile for medium lengths, and 4.95 cents per mile for long lengths. These charges have been raised, however, to reflect the additional revenue requirements of the carriers as the Board granted several requests for fare increases throughout 1974. The Board's current formula became effective April 29, 1975, CAB Order 74-12-110 (1974).

[299] Phase 9, DPFI Order 74-3-82 (emphasis added).

between December 1973 and November 1974.[300] Most of the DPFI standards and practices have been in effect since the early seventies; and, as Ralph Nader pointed out, the CAB has "been on a binge of industrywide price increases"[301] since that time. (See table 17 for examples of the rapidity with which cross-country fares rose between 1971 and 1974.)

The industry argues that rising fuel costs are responsible.[302] Fuel costs alone, however, did not justify fare increases of this magnitude. Although in 1974, the domestic carriers paid 22 cents a gallon for fuel that cost 12½ cents in 1973, their total costs increased by less than 7 percent as a result. The disparity between a 7 percent fuel-related cost increase and a 20 percent fare increase is great.[303] And the disparity between a 10 percent fuel-related cost increase for international flights and a 60 percent fare increase is even greater (see table 17).[304] Moreover, the Board's system allowed the carriers a 4 percent increase in fares in November 1974 despite the fact that the 9 percent return earned in the year ending September 1974 was the highest since 1966 (the fourth highest since 1956).

The subcommittee is convinced that the Board's ratesetting procedures are partly responsible for keeping fares higher than they might otherwise be. They also tend to inhibit industry efficiency. Their effect on profits is basically neutral; profits, at least in the long run, probably are no higher than is reasonable; they may be lower. This section will examine some of these adverse effects and try to identify specific defects in the process that may have contributed to producing them.

a. Effects on Price

Several features of the Board's ratesetting practices have tended to raise fares in general or on particular routes to unreasonably high levels.

1) The Board has set a "load-factor standard" that is too low.—Although the adoption of a "load factor standard" represents a decided improvement over prior Board ratesetting policy,[305] there are several indications that the standard chosen—planes that are on average 55 percent full—is too low.

Whenever consumers have been free to choose, they have chosen fuller planes and lower fares. Thus, in California during the 20-year period of open entry, load factors seldom fell below 70 percent[306] (see table 15, supra), and even today, with more restricted entry,[207] load factors in California average about 60 percent. For another thing, one can make a rough estimate of consumer preferences by estimating the value of waiting time to a passenger. If a passenger's time is assumed

[300] In December 1973, the Board approved a fare increase of 5 percent; it approved a 6-percent fare increase in April 1974; and it approved a 4-percent fare increase in November 1974. It also phased out discount fares during the period—which had the effect of increasing fares an average of 5.4 percent. More recently, since the subcommittee's hearings, the Board has reinstated some of the discount fares and approved fare cuts.

[301] See Hearings at p. 1151 (testimony of Ralph Nader).

[302] See Hearings at p. 116 (testimony of Dr. George James, ATA).

[303] Unit labor costs went up as well, however. Total costs, domestic revenue ton mile unit costs appear to have increased about 15 percent during this time.

[304] In the international area, the Board's fare setting power is more limited. Nonetheless, as the report on the subcommittee's November hearings point out, the Board has made inadequate efforts to keep North Atlantic fares low. See Senate Subcommittee on Administrative Practice and Procedure of the Senate Committee on the Judiciary, Procedures Relating to Minimum Charter Air Fares (1974).

[305] As previously explained, the standard may stop the "ratchet effect." See pp. 109, supra.

[306] See Hearings at pp. 464–87 (testimony of William Jordan).

[307] Since 1965 several airlines, including Air California, have begun service in California. There, despite state regulation, entry is still less restricted than elsewhere.

TABLE 17.—DOMESTIC PASSENGER FARE DATA

Pricing

DISTRIBUTION OF 1971 DOMESTIC TRUNK COACH TRAFFIC

Fare Category	% Total Traffic	% Generated	% Fare Discount
Full Fare	56 8%	–	–
Youth Standby*	4 0	54 5%	33 3%
Youth Reservation*	2 3	25.7	20 0
Family Plan*	11 5	19 2	15 4
Discover America*	9 6	26 7	12 5
Other Discounts	15 8	–	–

*Discount fare categories eliminated
Source: CAB Domestic Passenger Fare Investigation, Phase 9

NEW YORK TO LOS ANGELES WINTER ROUND-TRIP

	1971	% Increase	1972	% Increase	1973	% Increase	1974	% Increase
First Class	$410	6.8%	$410	0.0%	$436	6 3%	$486	11 5%
Regular Coach	326	6.2	326	0.0	336	3.1	374	11 3 3/
Night Coach	260	7.4	260	0.0	268	3.1	298	11 2
Youth Fare	216	40.2	216	0.0	209 to 302	1.0 to 39	eliminated 6/1/74	
Family Plan (Husband & Wife)	542	6 1	542	0.0	555 to 638	2 4 to 17	eliminated 6/1/74	
Family Plan (Parents, Two Children)	758	6 0	758	0.0	774 to 940	2.1 to 24	eliminated 6/1/74	
Discover America	260	–	285	9 6	285	0 0	eliminated 6/1/74	
Individual Tour Basing Fare[1]					232		261	12 5
Demand Schedule	NA	–	NA	–	189	–	230	21 7
Mid Week Excursion (7-9 days)[2]					189		281	48 7

[1]Plus required ground purchase of $130 or $65 per person for two or more.
[2]Pending CAB approval.

Source: Statement of Herbert Moser, Merrill, Lynch, Pierce, Fenner & Smith.

3/ The phasing out of discount fares is, according to the Board, equivalent to an additional 5% fare increase.

TABLE 18.— TRUNK CARRIERS' FUEL COSTS

[1972–74]

	1972	1973	1974
Local service (figures in thousands):			
Gallons	650.0	720.0	720.0
Dollars	80.0	100.0	150.0
Cents per gallon	12.5	13.2	21.4
Total expenses	883.0	998.0	1,199.0
Fuel as percent of total expenses	9.1	10.0	12.5
Domestic (figures in millions):			
Gallons	7,170.0	7,440.0	6,650.0
Dollars	830.0	930.0	1,460.0
Cents per gallon	11.5	12.5	22.0
Total expenses	7,076.0	7,968.0	9,263.0
Fuel as percent of total expenses	11.7	11.7	15.8
International (figures in millions):			
Gallons	2,090.0	2,140.0	1,840.0
Dollars	240.0	290.0	620.0
Cents per gallon	11.3	13.6	33.7
Total expenses	2,234.0	2,459.0	2,995.0
Fuel as percent of total expenses	10.8	11.8	20.7

Source: Civil Aeronautics Board.

to be worth approximately $10 an hour,[308] the present frequency of service is far too great, and present fares are too high. Such passengers would likely prefer lower fares and if necessary would accept less frequent schedules and full planes.[309] Further, even if a 55-percent load factor represented, on average, the tradeoff between lower fares and more waiting time that consumers desired when the standard was set in 1971, the situation must have changed since then. Increased fuel and other costs have increased the amount that the passenger must pay for the frequency of service associated with a 55-percent load factor. To some extent passengers must wish the resulting price increase to be lower and waiting time, if necessary, to be longer.[310] Finally, fares in the Hawaiian and Puerto Rican markets are considerably lower than fare levels elsewhere; and as a result, load factors are significantly higher. Yet there are no indications that service on those routes is inadequate.[311]

At the hearings the Board seemed to accept the notion that a 55-percent load factor is now probably too low and that as a result passengers are now paying too high a price to receive more service than they desire; there was no general agreement, however, about how high that standard ought to be.

Given the difficulty of determining through studies and hearings the level of service that the public desires, why, asked the chairman of the subcommittee, should not the public be given the opportunity to choose between different levels of service and price? The answers

[308] This figure is used both by the Air Transport Association and Professor Peck of Yale University. See Douglas and Miller note 36, supra.

[309] Douglas and Miller, note 36, supra, discuss these points in depth. It is interesting to note that between the end of World War II and 1960, load factors on the trunklines were almost always higher than 60 percent. See table 15.

[310] See Hearings at pp. 59–73 (testimony of Seavers and Miller).

[311] See e.g., notation 3320 at p. 27.

of the CAB were vague and, after 4 years of investigation, filled with promises of more study.[312]

2) *The Board's load factor standard represents an average.*—Since the 55-percent load factor standard is applied as an average[312a] to the industry as a whole, load factors on particular routes may differ widely from the norm. Thus, carriers fly higher than average load factors on routes which they monopolize and they fly lower than average load factors on routes where there is considerable competition.[313]

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[312] Consider the following dialog between the chairman of the subcommittee and the members of the CAB (Hearings at p. 1328):

Senator KENNEDY. Well, if we could get back to the matter of fares, it is quite clear that the low-fare carriers are able to charge lower fares because they get more people on the planes. We can go round and round with various interpretations, but this is really basic to the point, and I do not believe you have addressed it. As a matter of Board policy, why cannot the public have the opportunity for more seats in a plane and less cost? What can the Board do about encouraging that?

Mr. SIMMS. May I make two more points?

Number one, that overall subject is part of the issues before the select committee on regulatory reform that is currently operating within the Board. That certainly is a matter that will be studied.

Second, you will recall——

Senator KENNEDY. What is that? What is this select committee?

Mr. SIMMS. It is the so-called Pulsifer committee.

Mr. O'MELIA. That is a study we have with Mrs. Keyes, and headed by Roy Pulsifer for 6 months. It is an in-house study with outside help. This is one of the areas that we are trying to get some answers to.

Senator KENNEDY. When did you start that?

Mr. O'MELIA. In January, as soon as I took over as acting chairman it was set up and has a deadline of June 1. Well, actually the date was, the press release was January 31. We are concerned with the same questions that you are asking, Senator, and we hope this study will give us some guidance and some answers.

Senator KENNEDY. Well, leaving that study aside, I would just be interested in the general comments of the Board members about the kinds of alternatives we have been discussing being available to the American traveling public. Do the Board members think that this kind of alternative is something that the American people should have a crack at?

Mr. O'MELIA. I will turn the mike first over to Judge Gillilland, but I would like to clarify your question, the one you asked as a layman's question, as to what the Board's policy should be.

Senator KENNEDY. Yes, obviously there are other considerations; but just as a viewpoint, do you think that other factors being equal, offering less frequent air service but more seats in the airplanes and lower fares ought to be available as an alternative?

Mr. GILLILLAND. I think, Senator, like so many questions, that the answer of a Board member in this sort of thing needs to be a little guarded in view of the prospect of the need to pass on some of these questions in formal or quasi-formal proceedings.

Subject to that I want to say that I took note a little while ago of your mention of fuel, which I think is very important in this context, and whatever may be the reasons that argue for high load factors—and there are many of them—I think they take on a new proportion, and a very important one, in connection with the shortage of fuel. As far as I know there is no one who is watching that problem who does not have the view that we need to save. I know of no reason why the air transport industry should not participate in that saving right along with everyone else.

Now, it has, too, as I think the record of the industry may be on the proposal—the actual shortages has been pretty good over the last year or two in dropping consumption. But, in the future I think the name of the game in air transport is highload factors. We should not be flying planes around that waste fuel. We should get good mileage out of the fuel that is used. Now, it is not a simple business. I have a little trouble in distinguishing a particular class of travel, because I think we need to move in this direction clear across the board. * * *

The carriers have in fact demonstrated an ability despite this phenomenon to raise their load factors, and at some inconvenience to the public, without any doubt. But I think this is the way in which the proceedings should go in the future, and in fact the way they will go. I think that is too much of a speech, but——

Senator KENNEDY. No; that is fine. Could I hear just from some of the others?

Mr. O'MELIA. Mr. Minetti?

Mr. MINETTI. Senator, I cannot disagree with what has been said by Chairman O'Melia and also by member Gillilland and what has been said by Mr. Simms.

I, as one member, would like to see a carrier experiment with a high-density service in interstate commerce at lower prices and perhaps in selected markets * * *.

Senator KENNEDY. Mr. West?

Mr. WEST. Well, I agree completely. I do not think anyone could argue that we are going to have to change our mix a little bit with regard to perhaps charters and scheduled services, and that is going to have to change our mix a little bit with regard to perhaps charters and scheduled services, and that is going to have some good and some bad effects. We are going to have to balance it. But certainly, that is a trend that we are going to.

I think we are going to have to take a hard look at our charter policies, and not only the supplementals but the scheduled airlines themselves are going to have to consider increased uses of charters, because that involves a substantial use of a plant rather than a partial use.

[312a] Hearings at pp. 1329–30.

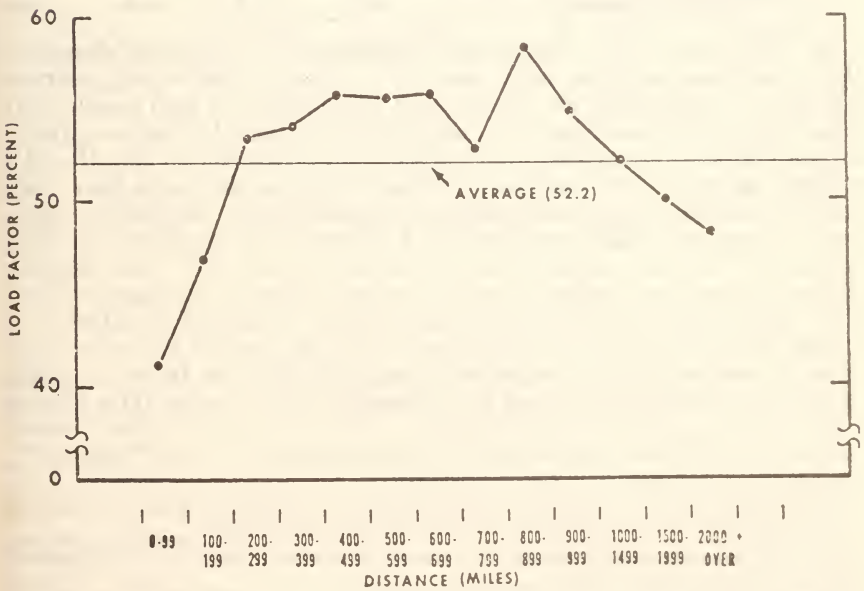
[313] In 1972 load factors on all monopoly markets averaged 55.2 percent. In markets with three or more competitors the load factor averaged 49.9 percent. See BOR study at p. 83. Moreover, average load factors in for example, 1973, were 51.3 percent. The fact that the industry has presistently (see testimony of Melvin Brenner of TWA Mar. 4, 1975) obtained load factors lower than the Board standard suggests that the Board's 12-percent profit figure may be too high, for the carriers have persistently competed away profits through excess scheduling to the point where it has sustained load factors which lead to actual profits considerably lower than 12 percent. This matter will be discussed further at pp. 128–30, infra.

Since most monopoly markets involve short- or medium-haul routes and longer transcontinental hauls are highly competitive, this tendency produces a result precisely the opposite of what most passengers want. Transcontinental passengers are to a greater extent pleasure passengers; since they plan their trips further in advance, they are less interested in having last minute space available; they are less likely to have business appointments the same day, and they thus have less need for many frequent departures. Shorter haul passengers, however, tend to a greater extent to be business passengers; they often want last minute space; and frequent departures are important, for they have often scheduled business appointments the same day. Thus, transcontinental passengers are relatively more likely to prefer lower fares and less frequent service than short-haul passengers. The Board's formula biases the system in just the opposite direction.

The Board's formulas aggravate this problem by promulgating a fare taper—a set of rules governing the relation of fares to each other—under which fares exceed costs to a greater extent on long hauls than on short hauls.[314] Competition on longer hauls then tends to produce emptier airplanes—lower load factors—than on shorter hauls, for the

TABLE 19

LOAD FACTORS IN NON-STOP SERVICE, BY DISTANCE, 1972
(EXCLUDES MARKETS WITH FEWER THAN 2,500 ANNUAL PASSENGERS)



See Table 10

Source: BOR study at 82.

[314] It should be noted that the Board's DPFI, formulas, in this respect, as in many others, represent an improvement over prior practice. Nonetheless, the problems set out in the text remain significant.

higher fare level allows the carriers greater room to increase costs by increasing the level of service on longer routes (see table 19).[315]

TABLE 20.—DPFI Debt Equity Data

[In percent]

	Actual cost of debt	Actual cost of equity	Actual debt/equity ratio	Debt/equity ratio used	Rate of return on investment: With actual debt/equity ratio	Rate of return on investment: With hypothetical debt/equity ratio	Rate of return on equity: With actual debt/equity ratio	Rate of return on equity: With hypothetical debt/equity ratio
DPFI—Phase 8:								
Administrative law judge	7.0	17.0	60/40	60/40	11.0	NA	17.0	NA
Board (in their decision)	6.2	16.75	60/40	45/55	(1)	12.0	(1)	16.75
Minetti/West (in dissent)	6.5	16.75	60/40	60/40	10.5	NA	16.75	NA

[1] The overall rate of return is a function of rates applied to the debt and equity components and the appropriate debt, equity ratio. Changing the debt/equity ratio requires a reconsideration of the rates for the debt and equity components/ Thus, it can not be assumed that the same rates of debt and equity would prevail under a different capitalization ratio. Assuming, arguendo, the 12 percent overall rate of return, and 6.2 percent cost of debt which the board found reasonable under the capitalization ratio are appropriate, were to be applied to a 60/40 debt equity ratio, the resulting return to equity would be 21.2 percent.

Note: Major witnesses, list name and organization. David A. Kosh for American, Delta, Eastern, Northwest, TWA, United; J. Rhoads Foster for Braniff, Continental, National, Western; and Victor H. Brown for Bureau of Economics (CAB).

	Investment: Most profitable	Investment: Least profitable	Equity: Most profitable	Equity: Least profitable
48-state scheduled passenger service, actual 1974 rate of return of selected carriers	11.98	2.18	19.80	−6.42

3) The Board insists that carriers charge equal fares for equal distances, thus preventing selective price cuts.—The Board insists that carriers charge the same fares for routes of equal mileage. It also insists that fares follow its phase 9 formula, which requires fares to increase gradually as distance increases. Such a system, contrary to the Board's claim,[316] is not a "cost-based" system, for air carrier costs may vary substantially between two routes of equal length, depending upon such factors as traffic density, air and ground congestion, or even weather.[317] Indeed, costs on any route may vary over time because of the tendency of traffic to peak at certain times of the day or year, the availability of crew, of the availability of terminal facilities.

The Board's insistence that fares follow its phase 9 formula—that fares on routes of the same mileage be equal and that fares on routes of different mileage be related by a formula that increases fares gradually with distance—has two harmful effects. First, a carrier cannot cut its prices in one market without cutting them in every market.[318]

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[315] See Department of Transportation. On long hauls the Board has consistently set fares that allow carriers to break even with load factors in the thirty's or forty's. See notation 330 at p. 27.

[316] In prepared testimony the Acting Chairman of the CAB argued that to rely increasingly upon competition to set rates would destroy the Board's "cost-based fare system." Hearings at p. 1389 (prepared testimony of Acting Chairman O'Melia).

The chairman of the subcommittee questioned the CAB on the factual correctness of this statement. Hearings at pp. 1335–36.

Senator KENNEDY. Now on the equal fares for equal distances, since the routes of similar distance may have different costs, how can you say that the fares are cost-based?

Mr. O'MELIA. Two markets could be the same distance but have no relation as far as density. The cost could be completely different.

Senator KENNEDY. So why do you have a principle of equal fares for equal distances? That is not really cost-based is it?

[317] See discussion at pp. 42–25, supra.

[318] Two qualifications are needed: First, the Board will allow selective price cutting if the price cut produces a fare taper that is closer to the cost taper, thus price cutting in all long-haul markets might be allowed. Second, price competition may occur to a limited extent through discounts. See pp. 136–41, infra.

It cannot cut prices selectively,[319] even if doing so would bring prices closer to costs, for selective price cutting would change the relationship between fares established in phase 9. Selective price cutting, however, is a primary way in which price competition takes place in industries with only a few firms. Because firms know that general price cuts will immediately be met, they tend to cut in only a few markets where they believe a cut might not be met, or despite its being met, they might maintain an initial advantage.[320] Gradually such selective price cuts tend to become generalized. But in such industries, to tell firms that they must cut prices across the board or not at all almost always means not at all, and the consumer is saddled with monopoly prices. For this reason, the antitrust laws make it unlawful for firms to agree to cut prices generally across-the-board, or not at all.[321]

Second, if fares are equal on equally long routes with different costs, fares on some routes must be well above costs. Were the Board's formula to apply in California, for example, the San Francisco-Los Angeles passenger would have to pay more than $40 instead of his present fare of $18.75. On such routes covered by the Board's formula, either the passenger is paying far more than cost, or more likely, carriers have scheduled extra service, driving costs up to meet high fares. Conversely, on those routes where fares are set considerably below cost, carriers will try to cut back service or escape it altogether. Recent cutbacks in service suggest that some have succeeded.

Given a Board fare policy that makes some routes significantly more profitable than others (as a rule of "equal fares for equal—but different cost—distances" must do) and a route policy that confines carriers to a historically determined set of routes, differences in profitability among carriers will, to some extent, simply reflect differences in route structure. This fact, recognized by the Board, leads the Board—for reasons of "fairness"—to award new routes to carriers with high-cost route structures instead of awarding them solely for reasons of economic efficiency or out of a desire to encourage rate competition.[322] In other words, one distortion (in rate policy) tends to produce another (in route policy), with the result that it is still more difficult for the Board to shape a low-cost route and rate system.[323]

The reasons why the Board has adopted these rules—rules that produce prices unrelated to costs and that inhibit selective price cuts capable of spreading throughout the industry—have nothing to do with helping consumers; rather those reasons are primarily administrative. The Acting Director of the Board's Bureau of Economics, when asked

[319] Discount fares constitute an important exception to this statement. Here however, "selective price cutting" is meant to refer to a cut of the general fare level in one, or several markets, but not in all markets.

[320] Compare the recent "no frills" price cut by National Airlines. Although National's new fares have been met by competitors, National seems to have maintained an initial promotional advantage. The Board, in this very recent case, seems to have departed from a strict interpretation of its phase 9 rules.

[321] See, for example, *Sugar Institute* v. *United States*, 297 U.S. 553 (1936). See also *U.S.* v. *Container Corp. of America*, 393 U.S. 333 (1969).

[322] See Keyes study in the separately bound appendix to the hearings; Fruhan, *The Fight for Competitive Advantage*, ch. 4 (1972).

[323] Moreover, the rule that equal fares must be charged for equal routes, together with the rule that short hauls must be less expensive than long hauls, produces fare problems of unbelievable complexity. Huge amounts of travel agents' time, and commuter time, has been required to construct fares between two small cities where service requires going from a small city to a large one to a second large one and then to a small one. The fare for this complex type of trip cannot be obtained simply by adding the fares for each of the segments involved, for it then might turn out to be cheaper to fly from a more distant city to one of the end points (or even to one of the intermediate points). Thus, considerable time must be spent checking direct fares of longer distance which will set an upward bound level of the connecting fare. And, this complex effort is made for routes that handle fewer than 10 percent of all travelers. The Board has taken action that will help simplify this problem, however, in requiring the citing of specific point-to-point fares for interline markets reporting 50 or more origin-destination passengers per year. The possible fare complexities of a more competitive system would at least flow from efforts by individual airlines to engage in price competition.

why the Board's fares were not cost-based, gave the following highly instructive reply:

> Mr. SIMMS. Just as an administrative matter under the present state of the art, it seems very very difficult, if not impossible, to attempt to regulate fares on a market by market basis in order to have a purely cost based fare structure. In other words, we simply do not possess the capability to make that refinement. [323a]

When Senator Kennedy asked Mr. Simms whether he was saying that in fact, "consumers are going to be paying higher fares in these markets because it is difficult to administer" the rate system, Mr. Simms replied, "Well I'm suggesting that it may be in fact impractical and impossible to administer."

The very fact that the Board cannot relate fares to costs on a market-by-market basis—that the Board feels it must use administrative mechanisms that prevent selective price cuts—is a strong argument that the Board should rely less upon its administrative mechanisms and more upon competition to produce low fares.

4) The Board's rules inhibit across-the-board price cuts.—As the CAB conceded, the Board's rules inhibit, not only selective price cutting,[324] but price cutting across the board as well. Suppose, for example, carrier A wishes to cut all its prices 10 percent. Before allowing the cut, the Board would examine what would happen if carrier A's price cut were met by carriers B, C, and D. If the Board estimates that, after matching price cuts, the industry taken as a whole would earn less than 12-percent profit, the Board will not allow carrier A's proposed cut. As Mr. Simms testified, if that "carrier today were to file a 10-percent fare cut, it would be most doubtful that allowing that fare cut to go into effect would square with the Board's ratemaking standards established in the DPFI * * * under the present DPFI standard the answer is "no." [325]

As a result a more efficient carrier cannot cut its fares, even if it expects to capture enough of the market to make a high profit. For such a price cut might—to the Board's dismay—drive less efficient carriers out of the market; the Board would prohibit such a cut because during the interim the industry might earn less than 12 percent. Removal of the threat of price competition from more efficient carriers is to destroy a most effective weapon for eliminating waste and forcing firms to adopt efficient business practices.[326]

Moreover, this inhibition on across-the-board price cutting helps to explain why fares are so high and load factors so low.

Were carriers free to compete in price, a carrier believing that passengers preferred fuller-plane, lower-fare service might cut its fares. If

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[323a] Hearings at p. 1336.

[324] Hearings at p. 1340. When Mr. Simms was asked whether, "It is the case that, if the carriers were to read the Board's rules, they will feel that it is not lawful under the Board's current rules to cut their fares in particular markets unless they want to cut fares across-the-board—is that right?" Mr. Simms replied, "Yes; that is correct." Hearings at p. 1341.

[325] Hearings at p. 1343.

[326] See pp. 125–127, infra. When asked why the more efficient carriers were not allowed to cut prices across the board Mr. Arthur Simms, Acting Deputy Director, Bureau of Economics, CAB, responded: (Hearings at p. 1343):

> Mr. SIMMS. Well, I think you have to go back to the basic concept of using industrywide average costs, rather than the cost to the most efficient carrier. That is a subject that the Board considered in the old General Passenger Fare Investigation case 1956-60; the decision on that and in the DPFI was attached to the chairman's Boston testimony.
>
> I might say that without going through all of that, it is a little simplistic to argue that because one carrier's costs, unit costs, are lower than the average costs, that is because its management is more efficient. There are costs which are within managerial control, and there are costs which are not, costs that are inherent in the route structure, and if you permit, for example, a carrier to reduce his fares on the basis of costs which may be based—which may be low because he has an advantageous route structure because of the overlapping route system we have, that fare reduction spreads to the entire industry. Then you may truly have a deficient fare level, which would result, as you point out, either in carriers going out of business, or in their inability to provide adequate service.
>
> Senator KENNEDY. Well, I gather the response to Professor Breyer's question was: No; they [the more efficient airlines] could not under the present rules lower fares across the board.

those price cuts were matched by its competitors, several or perhaps all carriers might lose money for a time. Eventually, however, if demand did not increase, one or more carriers would cut service leaving the consumer with fewer flights, but fuller planes and lower prices, and leaving the remaining carriers with a reasonable profit. A Board rule that allowing price cuts only when the industry will thereafter consistently maintain a 12 percent average profit stops the workings of this competitive process and forces carriers to compete through excessive scheduling instead.

5) The Board's profitability and elasticity figures are very inexact.—Although the figures used by the Board to measure a "reasonable profit" (12 percent) and to measure the probable response of demand to a change in fares (—0.7 elasticity) emerge from a complex hearing process, they are neither scientific nor precise. The subcommittee found considerable disagreement among experts about what "demand elasticity" actually is, and about what a "reasonable profit" ought to be. The subcommittee also found that the numbers that the Board uses may inpart an upward bias to the fare level.

a) Profits.—A "reasonable profit" is usually defined as the rate of return on investment that will just manage to attract needed capital to the industry. Any lower rate would drive firms from the industry, for they would not be able to replace their equipment; any higher rate would bring about too much investment or unnecessarily would drive up share prices, earning windfall profits for industry shareholders.[327]

The process of determining a "reasonable rate of return" is complex, involving a comparison of the airline industry with other industries of roughly comparable risk, or requiring an estimate of what return was needed in the past to induce investors to hold airline shares. The experts testifying in DPFI Phase 8, after examining share prices primarily in the sixties, concluded that an equity return of 16–18 percent was "reasonable"—and after taking debt into account the figure implies an airline profit of about 12 percent on total investment. The Board, over dissent, promulgated standards that would set returns between 16.75 percent and 21.2 percent on equity, depending upon the firm's ratio of debt to equity. See table 20.[328]

Some witnesses argued that this seemingly high rate of return is justified because the airline business is very risky, and its stock is highly volatile.[329] Since airline earnings, and airline share prices went through cycles of rapid rise and decline in the sixties, shareholders must obtain a fairly high return on average or they will not advance money to the industry in return for shares.

Other witnesses argued that the 12-percent figure is too high. First, the airlines have earned 12 percent or more in only 4 years since World War II. During most of the past 30 years, they have earned considerably less than 12 percent; yet they have managed to stay in business, and attract capital. Professor Caves concludes that between 1930 and 1960, the airlines earned, on average, almost exactly the same return as the corporate sector taken as a whole—about 7.5 percent after taxes.[330] Professor Keeler found that between 1960 and

[327] If the industry earns, for example, 18 percent when capital would be supplied at 12 percent, investors would rush to buy industry shares driving a share price for example of $100 to $150, where the $18 earned is 12 percent of the market price.

[328] The Board set a return of 16.75 percent on equity for a firm with a debt/equity ratio of 45/55. Since most airlines have less equity—most have a debt equity ratio of 60/40, the return (calculated on the 45/55 assumption) would earn 21.2 percent on equity. See table 20.

[329] See Hearings at p. 2240 (statement of Herbert Moser of Merrill Lynch, Pierce, Fenner & Smith). See also Hearings at p. 2234 (statement of Harry A. Kimbriel, Jr., of Alliance One).

[330] Caves, note 137, supra at p. 394.

1966 the average rate of return for the corporate sector as a whole was 7.8 percent; the airlines' average return was 7.5 percent.[331] Since the airlines have managed to obtain adequate capital for expansion while earning this rate of return (if anything, they have over expanded), a return roughly equal to that for the corporate sector as a whole, they claim, seems adequate.[332]

The industry's failure to fly 55 percent average load factors supports this view. If the 12 percent overall profit figure were right and if the industry could earn 12 percent only by achieving a 55-percent load factor, that load factor would be achieved, for otherwise firms would go out of business, removing aircraft from the industry. In fact, over the past few years while profit figures have been roughly comparable to the early sixties, industry load factors have been well below 55 percent (See tables 14, and 15). A lack of new investment in the industry has been claimed, but given the cyclical nature of demand and existing overcapacity, that fact is hardly surprising nor should it give rise to concern.

As the Department of Transportation pointed out:

> Carriers have been able to get financing, they have been able to get into the capital market at the rate of return of 6 to 8 percent. We suggest that the target of 12 percent is above the target which is necessary for them to be able to function effectively in the market place. . . . [G]iven the amount of excess capacity in the industry today—the overinvestment and the fact that many planes are grounded—it would be very inappropriate if the market were making funds readily available to the airline industry to go on a further binge of capital investment and plane purchases. This would be precisely the wrong direction for the industry to go at this point in my judgment. So the fact that the airline industry is not now 12 percent and cannot buy as many planes as it might if it did earn 12 percent, . . . certainly seems to be no evidence that it should have a 12 percent rate of return.[333]

TABLE 21.—TRUNK RETURN ON INVESTMENT, 1955-74

[In percent]

Year:	
1955	11.9
1956	9.6
1957	4.8
1958	6.5
1959	7.1
1960	2.8
1961	1.0
1962	3.6
1963	4.8
1964	9.6
1965	11.6
1966	10.2
1967	6.9
1968	5.2
1969	4.4
1970	1.8
1971	3.7
1972	6.0
1973	5.9
1974[1]	9.1

[1] 12 mo. ending 3d quarter 1974.

Source: TWA statement, Mar. 4, 1975. Compare this table with the CAB figures on p. 129. Because there are some minor discrepancies, presumably based upon different methods of calculation, both tables have been included in this report.

Second, the experts supporting 12 percent Phase 8 of the DPFI may not have answered the right question. They seem to have based their estimates on the return that investors in the industry expected

[331] See Hearings at pp. 1297.

[332] On the other hand, the stock analyst might point out that, while airlines, on average, during this period were earning fairly low rates of return, the holders of airline shares were earning high rates of return for the shares were rising in price and capital gains made up for low dividends. This price rise, it might be added, was caused in part by overly optimistic expectations—expectations that led shareholders to advance money for investment despite low corporate profits. Thus, the low profits that in the past were sufficient to generate high shareholder returns will not do so in the future. If investment is to continue, profit rates for the companies must rise.

[333] See Hearings at pp. 1181-82 (testimony of John Snow).

on their airline share investments throughout the sixties. Perhaps, taking capital gains into account, airline shareholders did receive about 17 percent to 21 percent on average in the sixties.[334] But, that fact does not show that investors must expect to receive about 17 percent return on their airline share investment—particularly if the Board intended through the DPFI standards effectively to achieve for industry shareholders a rate of return of about 17 percent.[335] If the Board's DPFI system worked—if fares could be set at levels where about a 17-percent rate of return on equity was in fact consistently earned by the industry, meeting the Board's load factor and other standards—the industry would then automatically become less risky and such a high rate of return on equity would no longer be needed.[336] Furthermore, rapidly changing economic conditions make it difficult to use a rough estimate of shareholder expectation in the sixties to predict a proper rate of return for the future. Indeed the excess capacity that the sixties return called forth suggests it may have been too high. The experts should have been asked to focus specifically on whether a different rate of return would be needed to attract a proper amount of new investment because of the changed regulatory conditions that would have occurred had the DPFI worked as intended. Of course, this question would have been impossible to answer precisely, but a vague answer would be better than none.

In sum, the subcommittee believes that the Board's Phase 8 profit goal of 12 percent overall—implying a return on actual equity of about 21 percent—provides a somewhat inflated idea of the proper level of industry profits. Since this highly competitive industry is most unlikely to attain that level of profits, the DPFI rules will often show a need for increased prices; those rules will not then act as much of a check on industry requests to increase price.

b) Demand elasticity.—The Board estimates that the elasticity of demand for air travel is −0.7. This figure means that for every 10 percent change in price, demand will change seven percent in the opposite direction. The fact that the −0.7 figure is less than −1.0, that demand is relatively inelastic, suggests that price increases, not price cuts, are required to increase industry revenues.

This view of demand elasticity has been criticized by several experts. Professor Peltzman's survey of the literature reveals studies by Professors DeVaney, Brown, and Watkins which suggest that demand is considerably more elastic than the Board estimates.[337] And as previously mentioned, market experience in California and in Texas suggest a highly elastic demand.[338]

[334] But see Hearings at p. 2284a (statement of Prof. Richard Bower of the Dartmouth Business School Professor Bower argues that the Board, in Phase 8, may have overestimated the return needed to attract equity capital even during the sixties. Professor Bower shows that between 1964 and 1973 as long as airlines earned between 10 percent and 15 percent returns on equity, the market price of a share of their stock was equal to or greater than the book value of a share. This fact suggests that the correct rate of return on equity was probably between 10 and 15 percent, for higher rates of return simply led the stock market to bid up the price of shares to the point where new investors earned only 10 to 15 percent. In other words, higher earnings were unnecessary to induce investment and produced only windfalls to shareholders. But see Hearings at p. 2240 (statement of Herbert Moser, of Merrill Lynch, Pierce, Fenner & Smith.)

[335] While the Board states that the 12-percent rate of return was not in any sense to be viewed as a "guarantee" rather, the carriers were given "the opportunity to earn 12 percent." Yet, the discussion above makes clear, in fact the Board's rate system is designed to guarantee the industry a 12-percent rate of return provided that the industry meets the load factor, and other standards set by the Board. See Hearings at pp. 1331-35 (testimony of Chairman O'Melia); CAB Order 71-4-58 (Apr. 9, 1971).

[336] Board notation 3320 states that the fact that the industry attracted capital to finance excessive plant throughout the sixties on the basis of average return on total investment between 6-8 percent suggests that the problem of overcapacity may be a structural feature of the industry under the impact of other regulatory features of the act. It also suggests that the investment community, insofar as debt capital is concerned, may regard air transportation as more secure than other industries "because of the security of route aspects of the act, together with the Board's entry and merger policies, and because the asset being mortgaged—aircraft—is highly fungible" (p. 29).

[337] See Hearings at p. 2234 (statement of Harry Kimbriel, Alliance One);

[338] See p. 46, supra.

If the Board is mistaken—if demand is in fact elastic rather than inelastic—then the Board's efforts to obtain higher revenues for the industry through a series of continued price increases are doomed to failure, for the price increases will drive away too many passengers to make service more profitable. Rather, efforts to tap new markets through lower fare service would be more likely to maintain industry profits.

The subcommittee cannot second guess the Board or the industry as to what demand elasticity is in fact like. Experts have told the subcommittee and its staff that demand elasticity varies considerably from one market to another and one must not place much faith in precise estimates. The subcommittee can only point out that the industry itself is uncertain as to the elasticity of demand, and assumes that demand elasticities vary, depending upon the type of route, the type of service offered, the time of year, and the time of day. This uncertainty is simply one added reason why the Board's mechanical faresetting process is unlikely to produce fares that are either "cost based," that somehow replicate fares that would be set in a competitive market, or that provide some "appropriate" solution to the problem of matching airline resources to consumer demand.

6) Certain features of the Board's automatic procedures produce a bias toward higher fares.—It should be recalled that the Board's DFPI faresetting process, roughly speaking, foresees (1) the publication of annual cost, revenue, and profit figures every 3 months; (2) the automatic application of the DPFI rules to those figures; and (3) subsequent applications for fare increases by the carriers. This sort of procedure, which was seen in nearly full-blown operation in November 1974, can increase the likelihood of unreasonably high fares because of the way in which it interacts with the Board's procedural powers to control rates.

For one thing, after any quarter in which adjusted industry figures show a profit of less than 12 percent, carriers can, in principle, apply for a fare increase, and fares will rise. Yet, after a quarter in which adjusted figures show profits above 12 percent, no carrier need apply for a fare decrease. Rather, carriers can continue to maintain the same high rates, waiting for the Board to act. The Board's powers to initiate a rate proceeding are far more difficult to exercise than its powers to approve or suspend a tariff that a carrier files.[339] Thus, the carrier's ability to file if it wants a higher rate, but to do nothing if a

[339] See FAA sec. 1002 "(g) Whenever any air carrier shall file with the Board a tariff stating a new individual or joint (between air carriers) rate, fare, or charge for interstate or overseas air transportation of any classification, rule, regulation, or practice affecting such rate, fare, or charge, or the value of the service thereunder, the Board is empowered, upon complaint or upon its own initiative, at once, and, if it is so ordered, without answer or other formal pleading by the air carrier, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, fare, or charge, or such classification, rule, regulation, or practice; and pending such hearing and the decision thereon, the Board, by filing with such tariff, and delivering to the air carrier affected thereby, a statement in writing of its reasons for such suspension, may suspend the operation of such tariff and defer the use of such rate, fare, or charge, or such classification, rule, regulation, or practice, for a period of 90 days, and, if the proceeding has not been concluded and a final order made within such period, the Board may, from time to time, extend the period of suspension, but not for a longer period in the aggregate than 180 days beyond the time when such tariff would otherwise go into effect; and, after hearing, whether completed before or after the rate, fare, charge, classification, rule, regulation, or practice goes into effect, the Board may make such order with reference thereto as would be proper in a proceeding instituted after such rate, fare, charge, classification, rule, regulation, or practice had become effective. If the proceeding has not been concluded and an order made within the period of suspension, the proposed rate, fare, charge, classification, rule, regulation, or practice shall go into effect at the end of such period: Provided, That this subsection shall not apply to any initial tariff filed by any air carrier."

Note that the Board need only suspend an application for a changed fare; it then ceases to take effect (for 6 months) while the Board investigates. If the Board initiates the investigation, however, existing (high) fares remain in effect until the Board concludes what may be a lengthy proceeding. The Board has tried to overcome this problem by providing that certain fare increases will automatically expire after a period of time.

lower rate is called for, makes it easier for it to obtain higher fares than for the Board to obtain lower ones. It should be noted, however, that this particular problem, while embedded in the Board's procedure, so far has proved of more theoretical than practical importance, for the carriers have not earned more than 12 percent.

For another thing, the Board's procedures tend to generate universal fare increases when adjusted industry profits are less than 12 percent without comprehensive inquiry into the question of whether lower profits are temporary or permanent, whether they arise from a particular sectional problem or from a problem that is widespread. Thus, nine carriers may have profits of more than 12 percent, while one carrier has such huge losses that the industry average is less than 12 percent; the Board's standards would allow all carriers to raise fares. Alternatively, a low industry average profit may be caused by unusual problems in one geographical area, that affect only a few carriers, or that are temporary, yet fares everywhere may go up as a result. The fact that industry annual profits at the end of one particular quarter are less than 12 percent does not show that a nationwide fare increase is necessary or desirable; yet, that is what the Board's ratesetting procedures tend to produce.

7. A concluding observation.—Many of the defects described above flow less from ill-will or incompetence than from the inherent difficulty of administering a system of classical ratemaking in an industry of highly competitive firms doing business in an ever-changing economic environment. The need for an easily administered system stops the Board from trying to set fares on a route-by-route basis. The need for efficient ratesetting procedures inhibits the Board from holding lengthy hearings that might elicit special circumstances showing that a rate increase should not be general. The need for a clear formula has led the Board to rely upon such numbers as a 12-percent rate of return or a −0.7 demand elasticity and to adopt fixed seating and load-factor standards, despite the uncertainty surrounding these numbers and the continuously changing economic conditions that can quickly outdate any set of numbers of standards. The need for "fair" proceedings has, at the same time, prevented the Board from meeting the need for quick change through informal negotiations with the carriers. More generally, the Board's desire for a comprehensive administrable fare-setting mechanism has led it to abandon totally in the ratesetting area its statutory mandate to promote "competition to the extent necessary to assure the sound development of an air transportation system." [340] While some of the difficulties listed in the past few pages might be overcome through a reordering of the Board's priorities away from its traditional concern about maintaining industry stability and profitability, there can be no *major* improvement without the abandonment of a purely administered rate procedure and the substitution of greater reliance upon the forces of competition in both route and rate areas.

b. Effects on Efficiency

The Board's rate policies, by preventing selective price cutting and inhibiting general price cuts, tend to tolerate inefficiency in the industry. Unregulated markets promote efficiency through the use of

[340] FAA, sec. 102(d).

both a carrot and a stick: the carrot is the prospect of increased profit as increased efficiency lowers cost; the stick is the fear that inefficiency risks the loss of customers to more efficient firms, which can more readily cut price. The Board has attempted to supply the carrot: by basing prices on industry averages, it allows more efficient firms to earn more money than less efficient firms. But, the Board has removed the stick. It will not allow more efficient firms to take customers from the less efficient by charging lower prices.

The net result is that air service is provided by a mix of firms operating at radically different levels of efficiency and prices that are considerably higher than an efficient minimum.[341] While comparative efficiency is difficult to measure, on almost any reasonable measurement—output per employee, average hours per day that aircraft are used, expenses per capacity provided—efficiency differs considerably from one carrier to another. Board figures for 1972, for example, show that Continental Airlines obtained 1.17 million available seat-miles per employee, United obtained about 1 million, TWA obtained only 798,000 and Eastern obtained only 705,000. Continental used its aircraft an average of 8 hours 56 minutes per day; United used its only 6 hours 54 minutes per day; TWA's average use was 7 hours 15 minutes per day, and Eastern's average was 8 hours 4 minutes per day. Still, Continental's expenses per available ton-mile were only 18 cents. United's were 22 cents, TWA's were 33 cents and Eastern's were 34 cents. It is thus not surprising that in 1973 Eastern lost $51 million on gross revenues of $1.2 billion, while Delta, the most profitable carrier earned $75 million profit on approximately the same revenue [342] (see table 22).

TABLE 22.—CARRIER EFFICIENCY (1972)

Carrier	Employees	Total operating expenses (millions)	Available ton-miles (millions)	Available seat-miles (millions)	Expenses per ATM (cents)	ASM per employee	Aircraft utilization per day
American	34,465	$1,309.6	5,502.5	33,033.2	23.8	958,455	7:45
Braniff	8,441	340.7	1,069.8	7,705.4	31.8	912,860	7:57
Continental	9,163	329.4	1,832.1	10,707.4	18.0	1,168,548	8:56
Delta/Northeast[1]	26,696	863.8	3,710.1	26,986.9	23.3	1,010,895	8:34
Eastern	33,157	1,107.8	3,219.5	23,404.3	34.4	705,861	8:04
National	7,625	324.0	1,438.2	10,547.2	22.5	1,383,239	7:35
Northwest	9,118	377.4	1,553.7	9,939.7	24.3	1,090,121	4:49
Trans World	32,680	1,339.3	4,018.8	26,089.9	33.3	798,344	7:15
United	48,690	1,638.1	7,487.5	49,359.1	21.9	1,013,743	6:54
Western	9,517	342.1	1,241.0	9,610.0	27.6	1,009,775	7:51

[1] Delta and Northeast merged in 1972. Data are sums for the 2 airlines, and may not be accurate.

Source: Civil Aeronautics Board.

Of course, these differences in cost and output figures do not entirely reflect differences in carrier efficiency, for carriers have different route systems and some route systems are more expensive to fly than others.[343] But route structures alone cannot explain these large

[341] Compare the testimony of Alfred Kahn the chairman of the New York Public Services Commission, Hearings at p. 96. "No cartel in history regulated or unregulated has ever done these things [e.g., produced goods at minimum prices]. The typical practice, instead, is to maintain price by imposing output quotas on the several members," efficient and inefficient alike. The Board's route policies, together with the difficulties it places in the path of any carrier wishing to take customers from another by charging lower prices, in effect imposes quotas upon the carriers. Those quotas have been highly effective, see table 10, p. 80, supra; and costs have been higher than the minimum.

[342] 1972 data submitted by the Civil Aeronautics Board.

[343] See Fruhan, note 322, supra, at ch. 2.

cost differences. Professors Miller and Douglas developed an equation that measures efficiency compensating for differences in route structure and different degrees of competition (see table 23). They found that Delta was most efficient, with costs 84 percent of average; Continental's costs were 90 percent of average, while Eastern's were 104 percent.[344]

TABLE 23.—ACTUAL UNIT COST PER AVAILABLE TON-MILE AS PERCENT OF STANDARD UNIT COST, 1962–70, AND PERCENT OF REVENUE PASSENGER-MILES IN COMPETITIVE MARKETS, 1970, BY DOMESTIC TRUNK AIR CARRIERS

Carrier	1962	1963	1964	1965	1966	1967	1968	1969	1970	Percent of revenue passenger-miles in competitive markets, 1970
American	115	113	112	113	102	99	100	98	95	83.0
Eastern	93	92	96	103	113	107	113	108	104	76.6
Trans World	115	111	113	112	114	113	111	112	109	91.1
United	103	106	101	101	107	103	103	99	97	67.5
Braniff	93	96	99	107	106	109	113	112	106	66.0
Continental	84	88	90	75	70	76	87	89	90	79.4
Delta	105	105	102	100	100	101	100	93	84	67.9
National	88	89	89	86	86	91	88	89	99	89.1
Northeast	115	127	118	119	116	120	100	119	116	88.9
Northwest	97	86	86	80	81	77	78	77	94	63.5
Western	95	89	96	101	102	(1)	108	108	113	73.4

[1] Not computed because of Western's merger with Pacific Northern in 1967.

Source: Miller and Douglas, Economic Regulation of Domestic Air Transport: Theory and Policy, p. 143.

Air Transport World recently explained some of these differences by pointing out that in 1974 "the least efficient carrier had a management 13 times the size of the most efficient and paid its managers an average of 63 percent higher salary." [345] Moreover, PSA, one of the lowest cost operators, has only five top corporate officers.[346]

On the other hand, the fact that lower costs result not only to some extent from greater efficiency, but also to some undefinable extent from the fact that some carriers have been given more favorable route structures, has unfortunately reinforced the Board's reluctance to allow price competition or to give carriers the right to charge lower prices.

For example, Mr. Simms, Acting Deputy Director, Bureau of Economics, testified that:

> There are costs which are within managerial control and there are costs which are not. . . . If you permit, for example, a carrier to reduce his fares on the basis of costs which may be low because it has an advantageous route structure . . . and [if] that fare reduction spreads to the entire industry, . . . you may have a truly deficient fare level.[347]

Whether the existence of different route structures is in fact a good reason for refusing to allow price competition is doubtful.[348]

[344] See Miller and Douglas, note 36, supra at p. 141. The cost equation takes into account stage length, the size of operations, and route density.

[345] See Hearings at p. 1345 (article by Colin H. McIntosh).

[346] See Hearings at pp. 464–87 (testimony of Prof. William Jordan). It is interesting to note that PSA achieved its low cost despite a cost for fuel considerably higher than that of the regularly scheduled carriers.

[347] Hearings at p. 1343. In his statement, Mr. Simms is reflecting long standing Board policy. In 1960 the Board stated that the way to deal with the fact that carriers have different costs is through "route realinements designed to produce a more balanced competitive structure." (32 CAB 291, 331.)

[348] Insofar as a route structure lowers a carrier's cost, it is, in a sense, a more efficient route structure. If as a result, some carriers can afford to charge lower prices, the result should be a more efficient network of service. On the other hand, some carriers may have routes that are more profitable (or less profitable) simply because of the Board's requirement that equal fares be charged for equal miles regardless of a route's actual cost. Insofar as this fact gives some carriers a cost advantage over others, the Board's policy are invidiously circular: A rigid fare structure gives some carriers cost advantages and those cost advantages (or disadvantages) are in turn used as reasons to justify a refusal to allow departures from the rigid fair structure.

The result of a fixed price system based on average cost is inevitably carrier inefficiency. Of course, the Board might investigate the efficiency of individual carriers directly and disallow excessive costs. But, it has made little effort to do so.[349] If it did, the fact that route differences may explain cost differences would make it difficult for the Board to determine whether or not carrier's management, or other costs are in fact excessive. Thus, once again, an irrationality in route-award policy has forced a compensating irrationality in the Board's rate policy,[350] with the result that fares are higher and efficiency lower than they otherwise would be.

C. Effects on Profits

Most witnesses agreed that Board rate policy has had little impact in raising the level of carrier profits (see table 15). A fixed price policy leads the airlines to substitute scheduling competition for price competition to the point where their profits, in the long run, reach a roughly competitive level.

Some witnesses argued that the fixed rate policy lowers carrier profitability. A leading Wall Street analyst, Herbert Moser, of Merrill Lynch, Pierce, Fenner & Smith, has pointed out that demand for air travel is highly cyclical because it is strongly affected by changes in disposable personal income. He believes that when disposable personal income falls—in economic downswings—the airlines should cut prices in order to increase demand. Yet, the Board's fare rules do not call for price cuts, in times of falling demand; rather, they may allow price increases as a cure for falling profits. The analyst concludes that, in his opinion, "the principal reason for the disappointing growth in travel since 1969 has been erratic (and currently negative) growth in real disposable personal income over the past 5 years and the perverse tendency of the industry to raise prices when real consumer income is declining."[351] This view is supported by testimony from one of the industry's most profitable airlines, that in a recession it is far better to lower prices to attract new passengers, rather than to raise them. Continental's witness concluded that the Board prevents "any kind of management innovation or ingenuity to try to cope with the economic situation that the carriers face."[352]

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[349] The chairman of the subcommittee questioned the CAB members on the question of efficiency standards:

Senator KENNEDY. Do you review the inefficiency or topheavlness of these airlines?

Mr. GILLILLAND. Well, sometimes with some distress. Senator, there is no doubt about that. I certainly will not contend that there are not differences in efficiency of some carriers and that is a matter of great concern to the Board.

Senator KENNEDY. What do you do about it when you find this out? Let me just give you the example that was printed in the Air Transport World, which states that there are major differences in efficiencies among the carriers and that the least efficient carrier had a management 13 times the size of the most efficient and paid its managers an average of 63 percent higher salaries.

Do you feel any responsibility to disallow the waste or unnecessary expenditures, or are these high costs just passed on in terms of additional fares to the consumer?

Mr. O'MELIA. A very pertinent and timely point. The Board is concerned about them, and I think the staff has been working on this standard. And I will let Mr. Simms carry on.

Senator KENNEDY. Well, just before we get to Mr. Simms, I would be interested in general, off-the-top reactions of members of the Board, and then we will hear from Mr. Simms. You are all thoughtful individuals and have given, obviously, a great deal of time to some of these issues, and I am just wondering whether you think this type of a question is legitimate and whether there should not be some kind of standard.

Mr. O'MELIA. Well, as one member, it is certainly probably most important where you have the local service carriers where they are on a subsidy, you certainly have to be careful and watchful more so with them because they are using Federal funds for a subsidy.

Now when a carrier is not on subsidy, a great degree of management—that is the area the less regulation, then the better for me. I am not an expert on how to run the airlines. Let the others do it. Where you had one airline last year that got into trouble financially and in the reorganization that had 36 vice presidents, if my memory is correct, it shows that the management had too many vice presidents, and this was the reason that their bottom line was in the red. A lot of the costs that are filed by the carriers in the Board for rate cases are disqualified. I think my testimony that I will get to shortly has $500 million as the figure. This is a problem. And I think that probably one of the good results of these hearings is to get a better focus on these points."

Hearings at pp. 1344–49.

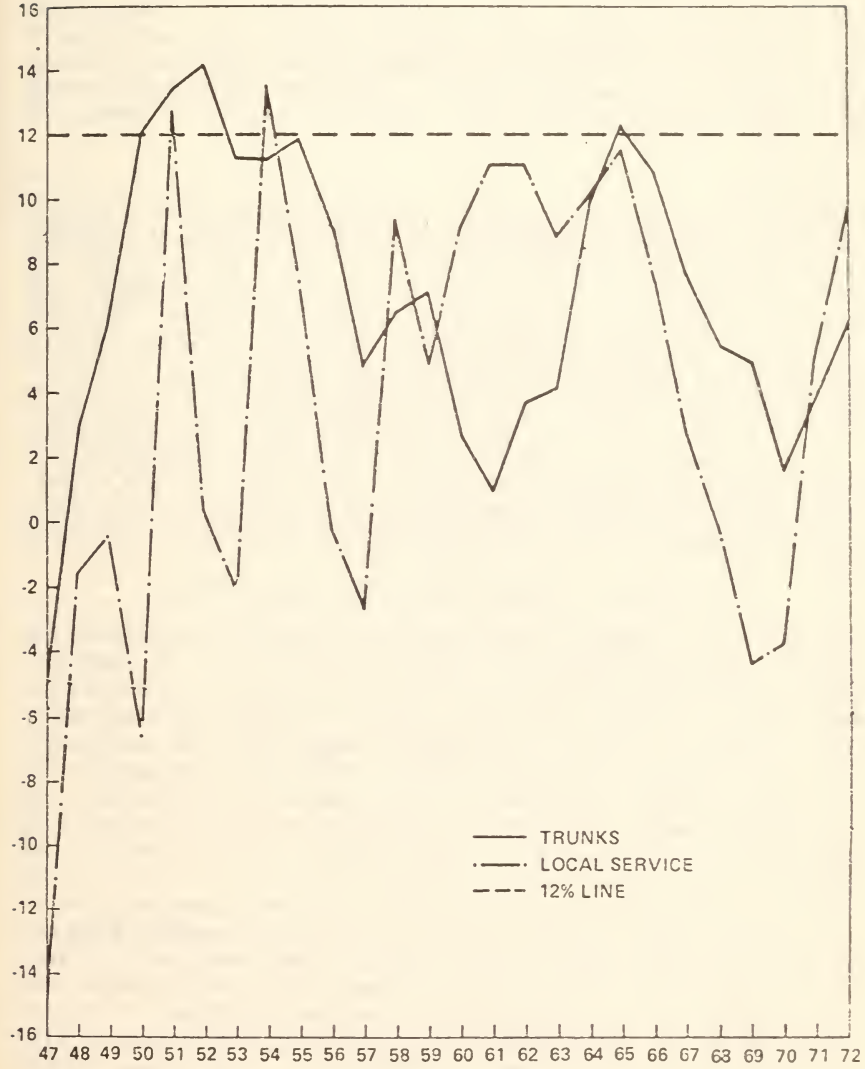
[350] See p. 119, supra.

[351] Hearings pp. 2240 (statement of Herbert Moser).

[352] Hearings at p. 1225.

TABLE 24

RATE OF RETURN ON INVESTMENT, TRUNKLINE AND LOCAL SERVICE CARRIERS, 1947-72



Source: BOR study, appendix P, ch 11.

Professor Peltzman states that the tendency of the Board's rate rules to prevent the industry from easily adjusting its prices to reflect changes in disposable personal income (and thus to match capacity to demand) is aggravated by its tendency to induce excess equipment purchases. He argues that the Board's decision to prohibit airlines from charging lower prices to fly on older airplanes produced a tendency to scrap the older aircraft sooner than the industry would have done otherwise. The result was a bunching of new aircraft purchases which have led to lower load factors, raised unit costs, and lowered profits. The extent to which the evil has occurred, however, is unclear.[353]

4. Alternatives.

Many of the defects mentioned in the preceeding section are inherent in any system of administratively fixed prices. Thus, the Board's present ratemaking system is unlikely to solve the problem described in section II—it is unlikely to produce fuller planes and lower prices. There are several major alternative methods that the Board has considered, or might consider, in order to cure the empty-plane, high-fare problem—in order to bring low fares to the consumer. These alternatives include (1) increased reliance upon fare competiton; (2) increased use of charter flights; (3) higher load factor standards; (4) more discounts; and (5) imposing strict controls on scheduling. The alternatives are not mutually exclusive. In the subcommittee's view, the first three of these alternatives are desirable, the fifth is undesirable, and the desirability of the fourth depends upon how the discounting is done.

a. Increased Reliance Upon Fare Competition

For reasons discussed at length in section II, a policy of open entry together with unregulated prices might well bring about the combination of service and price that most passengers desire; it would bring increased pressure for greater efficiency; and it could produce a level of carrier profits, in the long run, approximately similar to the profits that the industry has earned in the past. The major arguments for and against such a policy have been explored in section II. This competitive alternative looks considerably better after examining the Board's present regulatory policies, for the present system seems unlikely to bring about low fares. Rather, the present "regulatory alternative" is not a precise, scientific system that produces prices equal to cost or that brings about a level of service that passengers demand. Rather, that system turns out to be imprecise and complex—a system that is difficult to administer and that has built-in tendencies to produce prices that are too high and firms that are inefficient.

Nonetheless, the subcommittee, for reasons set out in section IIIA and section IIC9 above, does not recommend an immediate change to a system of open competition. The industry has grown up under a system of close regulation. It has planned, bought equipment, trained its managers and employees, on the assumption that that system would continue. It must have time to adjust to any radical change in those assumptions. Similarly, although the subcommittee does not believe

[353] See Hearings at p. 2265 (statement of Professor Peltzman.) The Board's Bureau of Economics states, however, that the Board has permitted price differentials between piston and jet aircraft, and that on a seat-mile basis, new aircraft have generally been more economical even after consideration of the additional depreciation and capital costs involved. (See comments on staff draft p. 7.)

serious harm (chaos, predatory pricing, inadequate service) is likely to occur, a measured, gradual approach towards open competition would allow Congress or the Board to retreat, should the subcommittee be proven wrong.

Three possible plans for increased price competition should be considered.

First, the Department of Transportation and others have urged that the Board adopt a "zone of reasonableness" in pricing that would give each airline the freedom to set prices anywhere within a zone of 15 percent above, or 15 percent below, the Board's current fare level.

The Board objected to this proposal on the grounds that "first it was likely that fares would tend to increase up to the top of the so-called zone of reasonableness. And, second, it would make a shambles of the cost-oriented fare structure which the Board had decided should be the basis for pricing air services." [354] The first of these objections does not take into account the fact that the Department has also proposed to liberalize entry requirements. The fear of new entry should prevent airlines from raising their prices to the top of the zone. The subcommittee's examination of the Board's system for setting rates reveals the fatal weakness of the Board's second objection: the Board's ratesetting system is not cost based, nor is it likely to keep prices low.

The subcommittee has two difficulties with the DOT plan: (1) The extent to which the threat of entry would keep prices low depends upon how easy it is for firms to enter the industry.[355] Since the subcommittee opposes immediate elimination of all restrictions on entry, but, instead favors a gradual liberalizing of route award policy, freedom for the carriers to raise their prices above present levels should also remain restricted until the threat of new entry is sufficiently important to keep prices low. (2) The DOT plan does not allow for sufficiently deep price cuts. Experience in Texas and California indicates that the airlines must make deep price cuts and keep them in effect for some time before they can hope to tap the large demand for cheap air travel. Thus, Southwest Airlines, for example, has been able to fill planes and make considerable profits by cutting its fares 40 percent for evening and weekend flights, while Eastern Airlines found that an off peak fare cut of only $3 had virtually no effect.[356]

For these two reasons, the subcommittee prefers a somewhat different pricing plan. It recommends that a ceiling be set on airline prices in accordance with the Board's present rules, but that any Board rule that tends to set a price floor be eliminated. Carriers would be perfectly free to set prices at any level below the ceiling price, subject only to the antitrust laws' prohibition of predatory pricing as enforced by the Department of Justice.[357] A single exception would allow a

[354] Hearings at p. 1389 (testimony of Chairman O'Melia).

[355] Mr. Simms of the CAB testified that, in his view, if there is anything short of completely open entry, fare flexibility will not work. If the application process for entry is complicated "the carriers would have no incentive to anticipate the possibility that somebody might file an application and have it awarded." Fare cuts are likely to come about only if "there is the possibility of reasonably quick entry by some outsider. Otherwise you have no incentive to reduce your fares." Hearings at p. 1355.

[356] Dr. Ehrlich of Eastern testified that "We filed for lower tariffs and the Board approved it, but we did not move a single passenger off peak. We found in that particular corridor we cannot ship them off peak. Senator KENNEDY, "How much did you drop?" "Dr. Ehrlich, I think it was $3." Hearings at p. 513.

On the other hand the Texas Aeronautics Commission has allowed Southwest to price pretty much anyway it wants. It reduced its off peak fares from $25 to $15. Hearings at p. 527.

[357] These rules basically follow the analysis of Areeda and Turner, "Predatory Pricing," 78 Harv. L. Rev. 697 (1975).

carrier to raise some its of prices above the CAB's ceiling, provided that the carrier shows: (a) That with existing prices incremental revenues in a particular route are lower than incremental costs, and (b) in the absence of a price increase, the route segment will not be served.[358] This pricing program is likely to produce fare experimentation, bring about lower prices, and possibly increased carrier profits.[359]

The major argument against this recommendation rests upon the fear that, *in the short run*, existing carriers will cut prices throughout their system to incremental cost, that they will be unable to cover their overhead, and that many will go bankrupt. This argument parallels that made in IIC9 above;[360] and partly for reasons discussed there, it seems more speculative than real. (1) Without significant additional entry, the industry is likely to lower its fares cautiously; indeed, the Board feared that without a price ceiling, pricing flexibility would mean price increases not price cuts. (2) All carriers have fixed costs, each realizes that neither it nor its competitors can cut prices to incremental costs throughout the system and survive; thus, each carrier is likely to proceed cautiously, as will its rivals. (3) The problem is, at most, a shortrun problem. If prices were cut to the level of incremental cost throughout the system, in the longer run firms would tend not to replace capacity, or to ground aircraft temporarily until ordinary growth in demand begins to fill these planes to the point where service at low fares becomes profitable.[361] (4) Cuts in prices may stimulate demand leading to increased carrier profitability, rather than reduced profits. (5) If bankruptcy threatens many existing carriers because they cannot survive the few years during which demand is inadequate to fill existing capacity even at low prices, mergers might, to some extent, be arranged. This possibility, however, carries with it dangers of its own, and is mentioned merely to suggest that a period of pricing flexibility is unlikely, even if every judgment made by the subcommittee is wrong, to produce catastrophe for the industry.

If the Board believes that the removal of any price floor is likely to force carriers into bankruptcy in the short run, there is a still more conservative approach that it might follow. The Board could impose a low downward floating price floor. It could allow airlines, say for the next 2 years, to cut their prices to 20 percent below the Board's current fare levels, and in the subsequent 2 years down to 40 percent below those fare levels, with the floor removed after that period of time.[362] The subcommittee believes, however, that the conservatism implicit in this approach is unnecessary.

In sum, the subcommittee recommends that the Board adopt a pricing policy of allowing fare cuts to take effect automatically, but that it follow its ordinary ratemaking rules in setting a price ceiling. This price ceiling would be subject to an occasional exception as set

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[358] By scrupulously assuring that the carrier satisfies the burden of proof on both these points, the Board should be able to hold breaches in its price ceiling to a minimum.

[359] Whether or not profits increase depends upon how demand responds to lower prices (see Hearings at p. 2240, statement of Herbert Moser).

[360] Pp. 74–76, supra.

[361] This is just the course that the major airlines are currently following due to an exactly parallel problem brought about through scheduling and service competition. United Air Lines representative testified that in 1971 United used 373 planes. By 1974 it was using 353 planes and "we have numerous airplanes on the ground at this point." Hearings at p. 1707. American Airlines estimated in the capacity restriction cases that even on a pessimistic estimate of ordinary growth and demand present capacity will be fully utilized, even at high prices, within 7 years (see table 8, p. 75, supra).

[362] Of course, there would remain the floor imposed by predatory pricing principles of the antitrust laws.

out above, and it would be removed when the Board determined that the threat of increased entry was sufficient to prevent the industry from conscious or unconscious collusion that sets prices significantly higher than competitive levels.[363]

b. Liberalized Charter Rules [363a]

The fuller-plane lower-fare problem can in part, be solved by removing restrictions on charter service—service specifically designed to provide that alternative. The current difference between charter rates and regular rates is large. The San Francisco–Boston regular round trip fare, for example, is $374; the charter fare is $182. The Boston–Paris regular round trip fare is ordinarily $750; the charter rate is $234. The New York–Las Vegas ordinary round trip fare is $328; the charter fare is $151.[364] The main reason for these differences is that on charter flights planes fly fuller.

The Board's present rules governing its three major types of charter flights are highly restrictive. The Board, for example, allows "affinity charters." But, to take such flights a passenger must have belonged to a bona fide club or fraternal organization for at least 6 months prior to the flight. Each passenger must pay a pro rata share of the flight's cost, which will vary depending upon how many passengers are actually carried; thus no one can know the exact fare until the time of departure. Chartering organizations find it increasingly difficult to fill today's larger planes with passengers who meet all these restrictions on membership.

The Board's "inclusive tour charters" allow a traveler to buy a vacation package including air travel, ground accommodations, and ground travel. No one can take such a flight, however, unless he is prepared to stop at least three times in places at least 50 miles apart and travel as a group throughout. Finally, the Board's "travel group charters" require that a passenger buy a ticket 60 days in advance, that he pay a 25 percent nonrefundable deposit, that he pay a final total fare based upon the number of passengers actually carried, and that he accept the fact that the flight will be canceled shortly before departure unless an 80-percent load factor is achieved. [365] It is hardly surprising that travelers are often unwilling to accept terms that mean that they cannot cancel their plans but the airline may have to cancel the flight. The Board's regulations impose further procedural obstacles to charter flights. [366]

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[363] It is important that the Board see that the point of the ceiling is to prevent "oligopolistic pricing"—not to prevent fares from going up anywhere in the country. Thus, if the industry proves sufficiently competitive as to produce significantly lower fares as a result of price cutting, that fact in itself will suggest less need for price ceiling. If, on the other hand, there is very little response to the Board's new policy, that fact will suggest continued need for a ceiling; but, in that case, there will be little pressure from the industry to raise the ceiling.

[363a] Since the subcommittee held its hearings, the Board, evidently taking note of criticisms, reported here, has begun to liberalize its charter rules. The report's description here, as elsewhere, is accurate as of the time the hearings were held.

[364] See Hearings at p. 565 (testimony of World Airlines); p. 1283 (NACA testimony).

[365] The Board also allows corporations or educational institutions to charter whole planes for employees or athletic teams. It should be kept in mind that the report describes regulation as it existed in February 1975. Thus more recent changes in charter rules have not been evaluated.

[366] For example, for a typical travel group application for a single flight there must be a transmittal letter, a TGC option agreement, a TGC agreement, a rider to a surety bond, a contract between organizer and participants, a TGC application form, and a TGC passenger name list. In total there are 62 pages that must be filled out. A passenger name list must have passengers numbered, alphabetized, identified as to whether they were on the main or standby list, identified as to whether they are departing or returning, together with their addresses and telephone numbers and some verification of identity through a document such as a passport or social security card. Moreover, if there is change in charter plans if it is to start a day earlier or return a day later or serve one additional city or one fewer city or a few people are to be added to the passenger name list, instead of simply amending the previous filing, an entire new application must be presented. If these changes occur within 90 days of the flight's departure, the entire flight may have to be canceled. See generally Hearings, at p. 939 (Overseas National Airways).

As a result of these highly restrictive rules, few domestic travelers fly by charter (see table 25). Thus, despite Los Angeles–New York round trip charter fares of $111 to $185, compared with the cheapest (night) coach fare of $276 (and regular coach fares of $346), only 14,700 passengers took charter flights between those two cities in 1974 compared with 66,000 taking night coach (and 348,000 flying regular coach). Experience on other routes is similar. Compared with this dismal record, charter flights in Europe, where rules are far more liberal (and regular fares are higher), are highly popular. Approximately 200,000 passengers took charter flights between England and Greece last year. And, on routes, such as London–Parma, where charter traffic has expanded rapidly, regularly scheduled service has not shrunk, but has grown rapidly as well.[367]

Last fall the Board proposed changed rules that would have restricted the charter flights even more severely. It would have eliminated affinity flights which account for more than 70 percent of charter traffic. It would have substituted a one-stop tour charter for the present three-stop charter—a desirable objective—but it would have limited the number of persons who could have flown on such flights to one-fourth of 1 percent of the scheduled airlines' traffic. This rule would have allowed the supplemental airlines to fly only 1 plane every 3 months between New York and Los Angeles or between Miami and Los Angeles. The subcommittee considered charter flights and fares including these proposed changes in its November hearings and January 15 report. The subcommittee is pleased to note that the Board has recently withdrawn these proposed changes and instead is considering other changes that would significantly liberlize charter rules.

The Aviation Subcommittee is currently considering proposals that expand opportunities for charter flights. These proposals introduce a one-stop tour charter and an advanced booking charter. This latter type of flight would offer low fares to any passenger able to make reservations 60 days in advance. In the subcommittee's view these changes are highly desirable. The Board might consider further liberalization, such as a 30-day, rather than a 60-day, advance-booking requirement, and less redtape for the organizer, travel agent, and airlines. Since the specific proposals for change in charter rules are currently before the Senate Commerce Committee and have been considered by its Aviation Subcommittee, they will not be discussed in detail here. The subcommittee will simply note its support for such changes; they constitute an important step that should be taken in the direction of providing fuller-plane, low-fare service.

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[367] See Hearings at p. 951 (submission of ONA).

TABLE 25.—DISTRIBUTION OF PASSENGERS BY TYPE OF FARE IN SELECTED MARKETS—1974

Fare Class [1]	Boston to Washington		Chicago to New York		Boston to San Francisco		Los Angeles to New York		Honolulu to Los Angeles	
	Fare [2]	Passengers [3]	Fare	Passengers	Fare	Passengers	Fare	Passengers	Fares	Passengers
1st class full fare	52.78	52,280	81.48	234,590	232.41	11,310	225.00	120,190	201.00	19,830
Deluxe night coach	39.81				179.63	650	173.15	5,180	Not available	1,820
1st class family plan	(4)	3,020	(4)	10,910	(4)	1,310	(4)	9,660	(4)	20
1st class group fares	43.52									
Coach full fare	39.81	428,720	62.96	1,078,600	179.63	61,450	173.15	348,040	123.00–139.00	118,430
Night coach	33.33	1,170	Not available	370	143.50	12,490	137.96	66,110	Not available	540
Youth fare	35.19	12,550	55.56	23,250	160.19–164.81	1,760	153.70–159.26	5,530	124.00	1,390
Excursions, group fares	32.41–34.260W	19,050	50.000W	28,420	106.48–129.630W	50,910	106.48–133.330W	223,960	209.00–263.00RT	52,600
Other discounts	53.70–62.96RT		100.00RT		251.85–313.89RT		241.67–300.93RT			
Coach family plan	(4)	28,450	(4)	68,490	(4)	3,320	(4)	21,420	(4)	230
Economy fare						9,130		28,780	116.00–131.00	120,010
Military and unknown		11,670		40,030		1,415		14,667		27,430
Charter			Average fare	4,878	62.34–79.340W (average fare) 131.92–147.96RT.		52.93–74.760W (average fare) 111.36–185.84RT.		50.62–77.050W (average fare) 108.36–176.14RT.	8,336

[1] Discount fares typically have restrictions attached. E.g., to get $106.48 discount fare Boston to San Francisco, passenger must make a reservation 90 days in advance and give $20 nonrefundable deposit. $209 round trip Honolulu to Los Angeles fare requires: (1) travel in group of 40 or more, (2) for a minimum of 7 days and maximum of 30 days; (3) a minimum $50 spent on ground accommodations, and (4) travel limited to Monday through Thursday.

[2] Fares given are fares effective May 15, 1974, except charter rates are the entire range of rates over 12 mo. ending Sept. 30, 1974, and are exclusive of ferrying charges.

[3] Passengers: Total local coupon O. & D. passengers for 12 mo. ending Sept. 30, 1974, based on 10 percent sample.

[4] Family plan—Full fare for head of family; 92 percent fare for 1st accompanying member (spouse or member aged 2 to 21); 92 percent fare for additional accompanying member 12 or older; 66⅔ percent fare for additional member aged 2 to 11.

Source: Compiled by the subcommittee from the files of the CAB.

c. Tightening Load Factor Standards

Perhaps the simplest way to fill planes and to reduce fares is to raise the Board's load-factor standard from 55 to 65 percent. As described in section II above, the higher standard will produce lower fares by forcing the airlines to fill their planes in order to remain profitable. A related more direct way to accomplish the same end is simply to lower the general fare level. As one of the Board's administrative law judges recently found:

> [The Department of Transportation] argues that if the fares in the dense long-haul markets—particularly the four transcontinental markets—are lowered, this would automatically increase load factors by giving carriers the incentive to limit their costs by reducing capacity and at the same time would cause a growth in traffic. The DOT evidence on this point was quite persuasive.[368]

Indeed, fares on Mainland-Puerto Rico routes are approximately 10 to 15 percent lower than those set under the DPFI formula; load factors are nearly 5 percentage points higher,[369]—presumably because at lower fares carriers simply must fill their planes to earn a profit; if they cannot, they must withdraw capacity from the market (see pp. 39, supra).

Increasing the Board's load factor standards, or lowering the general fare level to what it would be with higher load factors, does not, however, cure many of the DPFI's basic defects described in section III. The effect of any—even a high—general load-factor standard is still perverse, leading to more frequently scheduled service on longer routes, though passengers would probably prefer the opposite. Moreover, the Board would still insist upon mileage-based, rather than cost-based, fares; it would require similar fares for routes of similar mileage; and the whole network of procedural and substantive rules that inhibit price competition would remain in effect. For these reasons, the subcommittee views proposals to raise the load-factor standards as inadequate—perhaps desirable, but only very small steps in the right direction.

d. Discount Fares

During the sixties the scheduled airlines created an elaborate "discount fare" system that offered lower fares for family travel and for travel with stopovers of 1–6 weeks. The discount system was designed to charge high fares to nondiscretionary travelers such as businessmen and lower fares to those whom a lower fare might make more willing to fly. The object of discriminatory pricing is to fill the airplane by providing at least some passengers with lower cost service. At present some have proposed a return to a discount fare system in order to bring about fuller planes and lower fares. They have criticized the Board's DPFI standards that inhibit discount pricing. This complex subject can only be touched upon here. In the view of the subcommittee, greater freedom to experiment with discount pricing is desirable, but such freedom cannot itself constitute a satisfactory solution to the empty-plane, high-fare problem.

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[368] Hearings at p. 2043 (CAB docket 22908).

[369] For example, on May 1, 1975, the DPFI fare formula yields a fare 16 percent higher than the actual mid-week fare and 11 percent higher than the weekend fare. (*Official Airline Guide*, May 1, 1974.) The load-factor data is from *Aviation Week and Space Technology*, Apr. 29, 1974, at p. 31 (1972 and 1973 figures).

To begin, one must draw an important distinction between (1) *cost-based discounts* and (2) *pure price discrimination*. "Cost-based discounts" are price differences that reflect cost differences; "pure price discrimination" involves different fares paid for similar service with similar costs.

Cost-based discounts are highly desirable; off-peak pricing provides a good example. A lower, off-peak fare will encourage customers not to fly during peak hours or at peak seasons when planes are full; instead more will fly during peak hours or seasons when planes are empty. As a result less capacity is needed to fly the same number of people, and the total cost of airline service falls. Off-peak fares have been highly successful in Texas, and over the North Atlantic (see table 26). The carriers and the Board have been criticized for failing to encourage still more off-peak experimentation.[370] Similarly, advanced booking discounts represent "cost-based discounts" insofar as they reflect actual cost savings due to increased efficiency in traffic scheduling and a real saving in, say, ticketing costs, such discounts as a general rule should be strongly encouraged.

Pure price discrimination, on the other hand, is far more controversial; why, one might ask, should two customers have to pay different fares for identical service that costs the airline identical amounts to provide? Economists frequently answer this question by arguing that to allow price discrimination will sometimes lead a monopolist to increase his output (providing service he otherwise would not have provided) thereby benefiting new customers. Under some circumstances the monopolist may provide these benefits to new customers without hurting old ones. Price discrimination in a regulatory context, by a *regulated* firm, however, may be far less desirable.

Typically, three advantages are claimed to flow from systems of pure price discrimination. First, the airlines can make more efficient use of their existing equipment. Insofar as the "cheap" seats are seats that would otherwise be vacant and the "low-fare" passengers are passengers who otherwise would not fly, the price discrimination makes the "low-fare" passengers better off, the airlines better off, and even the "high-price" passengers better off, for "low fares" contribute something to overhead, allowing "high fares" to be reduced. Second, price discrimination can produce more rational investment decisions. Insofar as it fills airplanes and produces increased revenue, airlines will be encouraged to buy new planes to satisfy customers who (a) would not otherwise have flown and (b) when taken together as a group are willing to pay enough to cover the added cost of new capacity. Third, discriminatory pricing can be used to implement a variety of social, noneconomic purposes. It can be used, for example, to help families, to help the old, or to help others who, as a matter of social policy, deserve favorable treatment.

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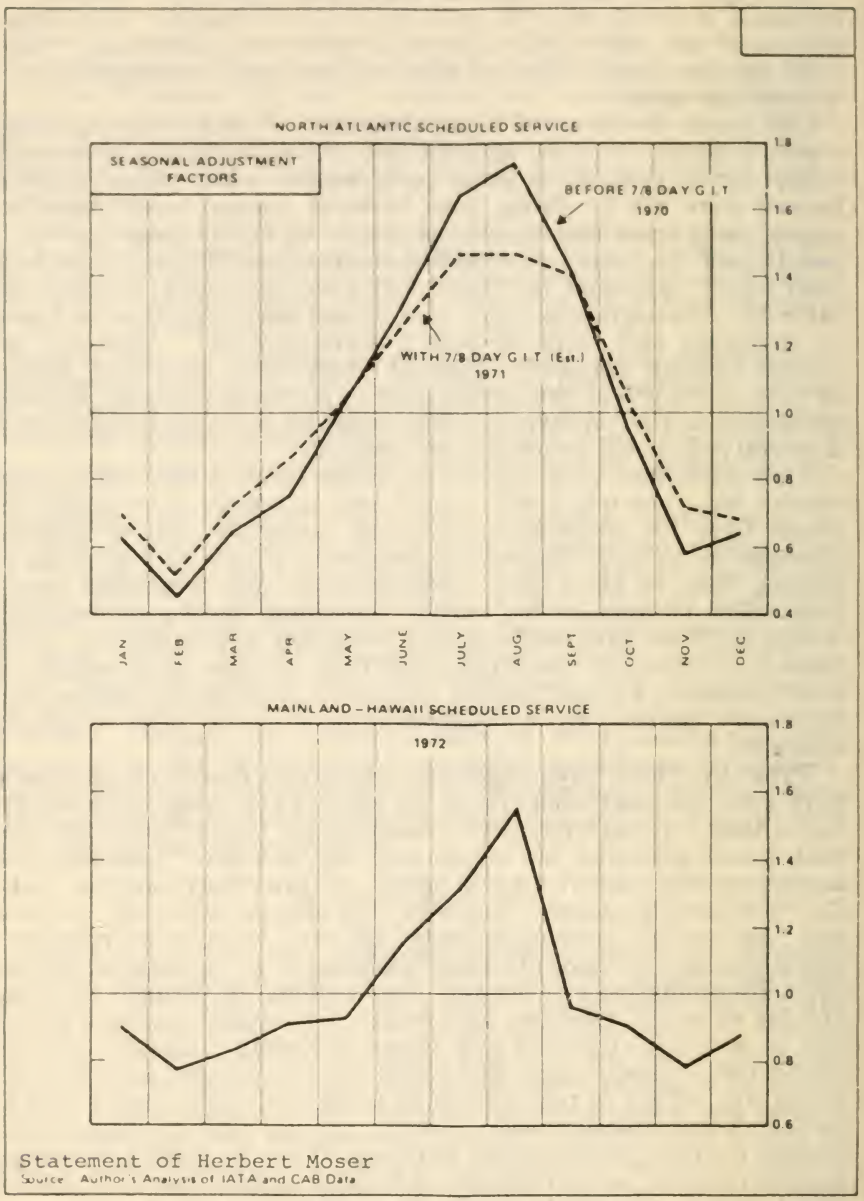
[370] Herbert Moser, for example, writes "there is a plant size and seasonal pricing structure that would maximize return on investment and the optimum mix is clearly different from that which exists today. As demonstrated in table 20, for example, the introduction of the 7-8 day GIT fares in the North Atlantic market in 1971 had a significant effect on the seasonality of that market and ought to be a signal that reappraisal of the pricing structure is in order. In a word, the industry ought to charge the maximum price that the traffic will bear and still fill the seats in the peak season, and the much lower price that will meet marginal cost in the slack season." Hearings at p. 2245 (statement of Herbert Moser, Merrill Lynch, Pierce, Fenner & Smith) Compare also the large off-peak discounts given successfully provided by Southwest Airlines and the insignificant off peak pricing experiment conducted by Eastern in the northeast corridor. See footnote pp. 356 supra.

TABLE 26.—SEASONALITY OF NORTH ATLANTIC AND HAWAII-SCHEDULED SERVICE



Source: Statement of Herbert Moser, vice president, Merrill Lynch, Pierce, Fenner & Smith, hearings at p. 2440.

On the other hand, some economists seriously question whether these "advantages" exist in the airline industry. If, for example, the presence of "low-fare" passengers reduces the "high" fare, it also subjects the "high-fare" passenger to unwanted crowding.[371] Moreover, if price discrimination produces extra revenue, that revenue, instead of being used to reduce fares, may simply be dissipated in the purchase of more aircraft.

[371] See Douglas and Miller note 36, *supra*, pp. 63–65, 97–98, for a thorough discussion.

Price discriminatory schemes in regulated industries typically contain other disadvantages—many of which arise out of the practical necessity of developing a "gate" that can be used to separate "high-fare" from the "low-fare" passenger. First, price discrimination strikes many as inequitable. It simply seems "unfair" to charge different prices to two customers who receive identical service. This "unfairness" is compounded if the "gate" is fixed so that some "high-fare" passengers can take advantage of the "low-fare." Suppose, for example, that the high fare is $200 and the low fare is $100. If large numbers of the $200 passengers buy $100 tickets, it may be impossible for the airline to cover its costs without raising the "high fare" from $200 to $300 (or, as in the North Atlantic, even to $750). In that case, the price discrimination has injured, not helped, the high fare passenger.[372]

Second, a price discriminatory system can lead to overinvestment. Suppose, for example, that it comes time to replace an airplane that carries some $200 passengers and some $100 passengers. Assume further that without change in costs or demand, the airline will replace the plane. Yet, also assume that the $200 passengers might be accommodated in $100 seats on other airplanes; and, assume finally that the remaining $100 passengers when taken together will not pay enough to cover the cost of a new plane. In that case, without price discrimination, the new plane would not be bought; with price discrimination, it would be bought. If the plane were purchased, however, the $200 passengers would in effect pay higher fares to help the $100 passengers fly in a plane that the $200 passengers would not need.[373]

Third, discriminatory fares are undoubtedly confusing. The subcommittee heard considerable evidence showing that the public dislikes and does not understand the vast proliferation of special discounts. Indeed, unless the airline chooses to promote a particular discount, the public is usually unaware of its existence.[374] And, the instructions to sell high priced tickets that some airlines give employees.[375] make it probable that many of those who fly will simply not learn about the cheap rates.

Fourth, most price discriminatory schemes provides service within classes on a "first-come-first-served" basis. Thus, $100 passengers may take seats from $200 passengers with the result that airline capacity will be used to serve those who are willing to pay less ahead of those who are willing to pay more.

Fifth, there are considerable administrative costs involved in any system of price discrimination.[376]

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[372] The Board has sought to overcome this problem by requiring that discount fares be so set that the revenue from increased traffic "generation" exceeds what is lost through "dilution." If the airline earns more from attracting new passengers then it loses by having old passengers choose the lower fare the airline should not have to raise the fares of the remaining high price passengers. This standard has not been applied to the North Atlantic, however, where, it is argued, this problem is directly responsible for astronomical fare increases.

[373] This example assumes that a discriminating carrier would be unlikely to shift the $200 passenger to the other airplanes. The practical difficulties of building a "gate" and the uncertainties as to which passengers are in fact willing to pay $200 and which would pay no more than $100 are sufficient to make this a realistic probability.

[374] See Hearings at pp. 820 ff. (testimony of Jens Jurgen Wegsheider).

[375] See pp. 170, infra.

[376] One airline executive proposed to subcommittee staff members an interesting system of price discrimination with a fairly high administrative cost. The airlines can predict fairly well in advance how many seats on each flight will go unused. They might sell approximately that number of seats on each flight at considerably lower prices. Ticket offices would offer that number of seats on each flight until they were sold. Computers would tell the ticket salesman how many cheap seats were left on each flight. Thus, the ticket salesman, with the use or computers, could explain to an inquirying customer exactly when he must fly in order to obtain one of the remaining cheap seats. Only a few airlines, however, have computer facilities adequate to this task.

Sixth, price discrimination may not be needed in order to fill airplanes. It is surely possible that a uniformly applied low price will produce customers sufficient to cover the cost of fuller-plane, low-fare service. That, certainly, has been the experience in California.[377]

The mix of good and bad features of pure price discrimination will vary depending upon the particular scheme proposed. The subcommittee believes, however, that in view of the many negative features of such schemes—particularly the confusion they cause and the sense of unfairness that they generate—the Board should not look to them for a comprehensive solution to the empty-plane, high-fare problem. As a solution, systems of pure price discrimination are far inferior to the nondiscriminatory low fares, or the cost-based fare discounts, that increased reliance upon competition may bring.

The subcommittee suggests the following conclusions related to fare discounts:

1. Cost based fare discounts that plainly reflect cost differences should not only be allowed, but encouraged.

2. The desirability of other price discounts should be determined in accordance with the following rank order:

Rank order No. 1.—Price discounts that bear some relation to differences in longrun costs. An "advance booking fare," for example, appears equitable, for it imposes much of the cost of the aircraft itself—the cost of capacity—upon passengers who book in the last few days. Since, without the need to supply space for such passengers, aircraft fleets could be smaller, planes would fly fuller, and fares would be lower, it seems equitable to charge them higher fares. Conversely, it seems equitable to charge a lower fare to those passengers willing to board at the last minute on a "space-available" basis. As long as they take seats from no one else, and are willing to run the risk of not finding a seat, it seems reasonable to charge them a lower price, more closely related to the extra costs of carrying them.[378]

Rank order No. 2.—Pure price discrimination that carries out long-established social policy. A discount for families is a discount that is well accepted and found in many areas of American life. Movie theaters, for example, often charge lower prices to children; families sometimes obtain special rates at hotels or restaurants. Of the various discounts that the airlines in the past have provided—for families, youth, and others—family discounts have perhaps the widest social acceptability.

Rank order No. 3.—Other forms of pure price discrimination. Discounts based upon "length of stay" seem least acceptable for there is no particular social policy they are designed to imple-

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[377] In principle price discrimination is desirable only if N (the number of passengers needed to fill the existing fleet to the point where, on a stochastic basis, queues for individual flights are kept at a reasonable level); times F (the fare) does not equal C (the cost of maintaining and flying the fleet). It seems reasonable to think that in the long run there exists an F such that N×F=C. And, such may be true in the short run, as well. See Turvey, "A Simple Analysis of Optimal Fares on Scheduled Transport Services," *The Economic Journal*, March 1975, at 1. Further, N should be so defined that the number of persons wishing to fly, but not obtaining flights times the amount they are willing to pay to obtain a flight is somewhat less than the cost of another airplane. Of course, this number, and the fare required to produce it, are as a practical matter, difficult, if not impossible, to ascertain. In principle, fares set at that level would prove economically efficient producing the right amount of investment and allocating existing capacity to those who are willing to pay for it. See, 2 Kahn, The Economics of Regulation, at p. 1-28 (1971). And, a competitive industry should tend to produce prices at that level. That is to say, such an industry will tend to set demand-based, rather than cost-based, fares and, over time, such demand-based fares should tend to induce that level of service for which passengers, in the light of the cost of producing service, are willing to pay.

[378] In practice, it proved difficult to offer a space-available fare, for those passengers trying to take advantage of it would sometimes make reservations under false names in order to assure the availability of space on the airplane.

ment, there is no difference in the cost of carrying the passengers, nor is there any particular explanation of cost allocation that somehow makes it appear fair to discriminate between those passengers who stay a short and those who stay a long time. Of course, the former are often business passengers; but the fact that the taxpayer pays 50 percent of the bill for most such travel—through business tax deductions—should remove any popular inclination to believe that it is socially desirable to charge business travelers higher fares.

3. If the subcommittee's recommendation to allow the carriers far greater freedom to lower prices is accepted they ought to have wide latitude to experiment with discounts as well.[379] As long as carriers are free to lower their prices, it will be difficult for any individual carrier to maintain an unwieldy, or unfair, discount system. Otherwise, other carriers will tend to lower their prices too, or to change their discount requirements to capture the "high-fare" passengers from the discriminating carrier. Thus, those discount systems that survive are likely to be cost-related or to respond to a widely felt need of the traveling public.

4. If the subcommittee's recommendation on pricing flexibility is not accepted, the Board should judge the desirability of price discounts in accordance with the rank order of "2" above. Of course, some discount systems may prove easier to administer than others; and ease of administration may justify acceptance of a scheme in a lower rank order.

e. Stricter Scheduling Controls

As a matter of logic, there is a very different approach that the Board might pursue in its efforts to solve the empty-plane, high-fare problem. It might try to increase its regulatory powers to control aircraft scheduling as well as price, and thereby to force the airlines to reduce service and to fill their planes. This theory underlies the Board's recent efforts to promote capacity restricting agreements. In principle such agreements, by reducing service on particular routes, might lead to fuller planes, thereby lowering industry cost, and eventually allowing the Board to insist upon lower fares. The subcommittee believes that this approach is impractical and that it will reduce the level of service without any corresponding reduction in the fare level. It will be discussed fully in part IIIC.

5. Summary of rate recommendations.

The subcommittee's major recommendations concerning rate policy include the following:

1. The Board should allow carriers flexibility to set the prices they desire. It should retain a price ceiling based upon present rate setting principles, but remove any price floor. A lower bound on prices would be determined by the antitrust laws prohibition against predatory pricing. Exceptions to the price ceiling should be made only in unusual cases, upon a demonstration that service on a particular route would be canceled or severely reduced in the absence of a price increase.

[379] American Airlines, for example, has suggested the possibility of standby fares, part charter flights steerage class, and advance booking fares. See Hearings at p. 1141 (letter to Stephen Breyer from Randall Malin, Apr. 4, 1975). And other airline officials have discussed the system described in note 376, supra. Given the uncertainties of demand, only experimentation with such systems can determine which are desirable, and would survive the test of the market.

When route award restrictions are eased to the point where the threat of entry will hold down prices, the price ceiling can be removed.

2. Restrictions on charter travel should be significantly liberalized along the lines provided in sec. 421.

3. Price discounts that clearly reflect cost savings should be automatically allowed.

4. The carriers can be allowed wide latitude to introduce discounts that embody price discrimination if the first recommendation above is adopted. The Board should evaluate price discriminatory proposals in accordance with the rough ranking set out at pp. 141–42. The Board might use this rank order and preceding analysis in exercising its power to set aside prices on the grounds that they are unreasonably discriminatory.

C. ANTITRUST: CAPACITY RESTRICTING AGREEMENTS

1. Introduction.

The CAB's power to grant immunity from the antitrust laws stems from sections 412 and 414 of the Federal Aviation Act.[379b] Section 412 requires the carriers to file with the Board any agreements involving earnings, losses, traffic, service, equipment, rates, safety, eliminating destructive competition, or regulating schedules. The Board is instructed to approve those that are in the public interest and to disapprove those that are not. Section 414 immunizes any agreement that is approved from the operations of the antitrust laws.

Approximately 8,000 agreements were filed with the Board between 1967 and 1974 (see table 27). According to the Board's staff, 87 or about 9 percent, of the proposed agreements filed in 1974 raised significant antitrust issues.[379c]

TABLE 27.—SEC. 412 AGREEMENTS FILED WITH THE BOARD AND DISPOSED OF 1967-74

Fiscal year	Trade association agreements		Additional major agreements		Other agreements	
	Received	Processed	Received	Processed	Received	Processed
1967	182	181	104	85	762	775
1968	189	182	83	118	782	789
1969	200	215	83	89	852	812
1970	170	144	68	50	862	848
1971	212	194	63	53	688	648
1972	145	168	55	51	816	723
1973	154	111	27	33	595	585
1974	177	200	65	67	723	692
Total	1,429	1,395	548	546	6,080	5,872

Note: Total receipts for period 1967-74, 8,057; total processed for same period, 7,813.

Source: Hearings at p. 1790 (letter from William B. Caldwell, Director, Bureau of Operating Rights, CAB, to Senator Kennedy, dated Feb. 28, 1975).

The most controversial agreements concerned (1) restriction of capacity offered on particular routes; (2) travel agents' fees; (3) mutual aid by the carriers in case of a strike; (4) division of landing "slots" at airports that limit total flights; (5) efforts to induce charter carriers to enter into minimum fare agreements. (The minimum charter rate

[379b] 72 Stat. 770, 49 U.S.C. 1382, 1384.

[379c] See Hearings at p. 1790 (letter from William Caldwell, Jr., Director, Bureau of Operating Rights, CAB, to Senator Kennedy, dated Feb. 28, 1975).

agreements were the subject of subcommittee hearings last November.)[379d]

During its recent hearings, the subcommittee focused primarily upon the antitrust immunity that the Board provided for carrier agreements that limit the amount of service supplied on particular routes—perhaps the most controversial exercise of the Board's section 414 power in recent years. These agreements are also directly related to the basic regulatory problem facing the Board—how to set rates in a way that does not produce wasteful overcapacity.

2. The capacity restricting agreements.

In 1970 the major airlines found that they had considerable excess capacity, and that they were losing money—primarily because they had overestimated demand for air travel. During that summer American, TWA, and United—the Big Three carriers—met and agreed to restrict the number of scheduled flights in 15 long-haul markets served exclusively by these airlines. In August 1970, these carriers asked for CAB approval. The remaining carriers, the Department of Justice, and the Department of Transportation opposed the Big Three. The Board rejected the proposed agreement on the ground that the carriers should have asked for approval before discussing the matter.[380]

On March 11, 1971, the Board granted all carriers permission to discuss capacity reduction agreements.[381] On the basis of discussions held between March and May, American, United, and TWA agreed to reduce capacity approximately 28 percent in four major transcontinental markets.[382] The Board, after refusing to hold a hearing, approved these agreements on a temporary emergency basis.[383] In June 1972, the Board, again after rejecting requests for a hearing, approved capacity restricting agreements between American, Eastern, and Pan American for the New York–San Juan market.[384] In November 1972, by a 3 to 2 vote, the Board extended all these agreements.[385] On July 27, 1973, the Board again extended the transcontinental agreement and set it for hearing.[386] The hearing lasted 16 months and culminated in a finding by the administrative law judge that the temporary emergency agreements were unlawful.[387]

In the fall of 1973, shortly before the expiration of the Boa d's extension of the temporary emergency transcontinental agreement, the Board authorized all carriers to discuss capacity reduction agreements in order to save fuel.[388] American, TWA, and United, meeting on October 16, 18, and 19, 1973, agreed to reduce capacity in 20 markets and submitted the agreement to the Board on October 23, 1973.

[379d] Subcommittee on Administrative Practice and Procedure of the Senate Committee on the Judiciary. *Procedures Relating to Minimum Charter Air Fares*, staff report, committee print, 93d Cong., 2d Sess. (1974).

[380] CAB Order 70-11-35 (Nov. 6, 1970).

[381] CAB Order 71-3-71 (Mar. 11, 1971). For a detailed chronology of the events relevant to these agreements, see Hearings at p. 1694.

[382] New York/Newark–Los Angeles, New York/Newark–San Francisco, Chicago–San Francisco, and Washington/Baltimore–Los Angeles.

[383] CAB Order 71-8-91 (Aug. 19, 1971) (dkt. 22908), reprinted hearings 1805.

[384] CAB Order 72-6-70 (June 16, 1972) (Minetti and Murphy dissenting) (dkt. 22908), reprinted in Hearings at p. 1884.

[385] CAB Order 72-11-6 (Nov. 2, 1972) (Minetti and Murphy dissenting) (dkt. 22908) (transcontinental agreement) reprinted in Hearings at p. 1818. CAB Order 72-11-7 (Nov. 2, 1972) (Murphy and Minetti dissenting) (dkt. 22908) (San Juan agreement) reprinted in Hearings at p. 1891.

[386] CAB Order 73-7-147 (July 27, 1973) (Murphy dissenting) (dkt. 22908). By CAB Order 73-8-59 (Aug. 10, 1973) (Murphy dissenting) (dkt. 22908), reprinted in Hearings at p. 1902, the San Juan agreement was extended again.

[387] *Capacity Reduction Agreements Case*, Initial Decision (Nov. 18, 1974) (Judge E. Robert Seaver) (dkt. 22908); reprinted in Hearings at p.1984.

[388] CAB Order 73-10-50 (Oct. 12, 1973) (dkt. 25990), reprinted in Hearings at p. 1911.

The Board approved them 2 weeks later.[389] Capacity restrictions to save fuel were also agreed to in nine small markets.[390]

In March 1974, the temporary emergency transcontinental agreement expired; but in July, the Board approved exactly the same agreement, this time as an agreement designed to save fuel. The Board extended the 20-market agreement for the same period.[391]

On November 18, 1974, the CAB's administrative law judge announced that the temporary emergency transcontinental agreements were unlawful. Since that decision, the Board has extended the fuel saving 20-market agreement and the fuel saving transcontinental agreement—which are identical to the agreement that the administrative law judge considered unlawful—until June 1975, or until it reached a decision on the appeal from the administrative law judge's initial decision.

The gist of this complicated set of administrative maneuvers is that agreements reducing capacity in four major transcontinental markets have been in effect since October 1971, agreements reducing capacity in 19 or 20 other markets have been in effect since October 1973, and an agreement restricting capacity in the New York-San Juan market was in effect, off and on, from June 1972 to March 1974. Until late 1973 the agreements were viewed as emergency economic measures. After late 1973 they were viewed as fuel saving measures. No hearing was held on any of these agreements until mid-1973 when a hearing was ordered that concluded in November 1974.

Throughout this period the Big Three carriers argued that the agreements were necessary to prevent excessive competition. All of the carriers had ordered too many new jumbo jets; the temptation to put these jets in service as long as flights covered their incremental costs led the transcontinental carriers to increase schedules to the point where they were losing money, flying planes that were only 30–40 percent full. By agreeing to reduce the number of flights, they would fly fuller planes, lower their cost, and increase their profits; perhaps fares could be reduced.[392] In 1973, the carriers made the additional argument that capacity-restricting agreements would help save fuel.

The recent opinion by Administrative Law Judge E. Robert Seaver discusses and documents the basic arguments for and against capacity-restricting agreements in detail.[393] This report will summarize the evidence presented to the subcommittee related to those claims. That evidence supports Judge Seaver's conclusion that these agreements are unwise.

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[389] CAB 73-10-110 (Oct. 31, 1973) (dkt. 25990), reprinted in Hearings at p. 1913, affirmed *United States* v. *CAB*, 511 F. 2d 1315 (D.C. Cir. 1975).

[390] Each of these agreements involved one or more of the Big Three—American, TWA, or United—and one other airline except for an agreement between Eastern and Pan Am.

[391] CAB Order 74-7-105 (July 24, 1974) (Minetti and West dissenting) (dkt. 25990), reprinted in Hearings at p. 1927.

[392] See Fruhan, *The Fight for Competitive Advantage*, at p. 168.

[393] *Capacity Reduction Agreements Case*, Initial Decision (Nov. 18, 1974) (dkt. 22908), reprinted in Hearing at p. 1984.

3. The effects of the agreements.

The capacity-restricting agreements have had the following effects:

(a) Capacity has been reduced substantially in the agreement markets. Load factors may have increased 10 percentage points or more—see table 28—in 1969, for example, there were 30 daily nonstop departures each way between Los Angeles and New York; in 1974 there were 15 each way.[394] American Airlines reduced its use of 747's from 10 hours per day in the third quarter of 1971 to 8½ hours per day in the fourth quarter.[395]

TABLE 28.—LOAD FACTOR CHANGES DUE TO THE TRANSCONTINENTAL CAPACITY REDUCTION AGREEMENTS

[In percent]

	Transcontinental agreement markets		19 comparable markets (no agreements)	
	Before agreement (1970/71)	After agreement (1971/72)	Before agreement (1970/71)	After agreement (1971/72)
October	36	54	(1)	48
November	31	47	(1)	43
December	35	52	(1)	48
January	34	52	45	47
February	30	45	41	42
March	31	49	42	47
April	37	54	48	(1)
May	37	55	46	45
June	46	56	53	54
July	50	60	55	58
August	51	64	59	60
September	44	56	48	49
Average	39	54	50	49

[1] Data not available.

Source: Capacity Reduction Agreements Case, Initial Decision at p. 31 (Nov. 18, 1974), reprinted in Hearings at p. 2020.

(b) As a result of the agreements, carrier profits increased significantly. Since costs fell, and load factors increased, profits on such capacity-restricted routes such as Chicago–San Francisco, Los Angeles–New York City, Los Angeles–Washington, and New York–San Francisco increased to between 17 to 24 percent (see table 29).

[394] Hearings at p. 1707 (testimony of Randall Malin, vice president, marketing and planning, American Airlines).

[395] Hearings at p. 1721 (testimony of Randall Malin, vice president, marketing and planning, American Airlines).

TABLE 29.—RETURN ON INVESTMENT AND LOAD FACTORS IN TRANSCONTINENTAL MARKETS WITH AND WITHOUT CAPACITY REDUCTION AGREEMENTS

[Fiscal 1973]

Market and equipment	Annual flights (BOR-IR-IC)	Annual ROI (thousands) using assumed 48 percent tax rate	Percent ROI using assumed 48 percent tax rate (percent)	Annual ROI (thousands) using 24 percent tax rate	Percent ROI using 24 percent tax rate (percent)
RETURN ON INVESTMENT AT ACTUAL SERVICE AND LOAD FACTOR LEVELS					
CHI-SFO:					
Narrowbody	6,781	$6,252		$8,537	
Widebody:					
3-engine	1,181	1,933		2,682	
4-engine	1,373	2,500		3,401	
Total		10,685	14.3	14,620	19.6
LAX-NYC:					
Narrowbody	5,182	7,561		10,551	
Widebody:					
3-engine	435	746		1,037	
4-engine	4,213	14,762		20,800	
Total		23,069	21.2	32,388	29.7
LAX-WAS:					
Narrowbody	4,260	5,325		7,395	
Widebody:					
3-engine	603	739		1,006	
4-engine	724	2,163		3,029	
Total		8,227	17.7	11,430	24.6
NYC-SFO:					
Narrowbody	4,833	4,770		6,471	
Widebody:					
3-engine	297	723		1,010	
4-engine	2,413	6,501		9,005	
Total		11,994	14.7	16,486	20.3
Grand total		53,975	17.33	74,924	24.1
RETURN ON INVESTMENT ASSUMING A 25-PERCENT INCREASE IN CAPACITY UNDER NONRESTRAINT					
CHI-SFO:					
Narrowbody	8,476	4,001		5,130	
Widebody:					
3	1,476	1,433		1,913	
4	1,716	1,558		1,961	
Total		6,922	7.4	8,977	9.6
LAX-NYC:					
Narrowbody	6,478	5,396		7,268	
Widebody:					
3	544	491		641	
4	5,266	11,269		15,503	
Total		17,156	12.6	23,422	17.2
LAX-WAS:					
Narrowbody	5,325	3,600		4,777	
Widebody:					
3	754	392		480	
4	905	1,578		2,142	
Total		5,570	9.6	7,399	12.7
NYC-SFO:					
Narrowbody	6,041	2,513		3,051	
Widebody:					
3	371	564		767	
4	3,016	4,316		5,628	
Total		7,393	7.3	9,446	9.3
Grand total		37,041	9.5	49,244	12.7

Source: Capacity Reduction Agreements Case, Initial Decision at p. 36–37 (Nov. 18, 1974), reprinted in Hearings at pp. 2025–26.

(c) Some cities were hurt significantly by a resulting decline in travel. Las Vegas, for example, testified that as a result of the capacity restricting agreements, load factors in the Denver–Las Vegas market ranged from 80 to 90 percent. And even at the 72 percent average load-factor standard that the Board has approved for those agreement markets, many passengers find planes full when they call for reservations. Las Vegas estimated that in the 2 months of February and March 1974 it lost approximately $1 million in nongambling revenue because between 8,000–10,000 passengers, who otherwise would have traveled to Las Vegas, were unable to secure plane transportation to get there.[396] Similarly, the Maryland Department of Transportation testified that, as a result of the capacity restricting agreements, carriers could abandon Friendship Airport and operate all their Washington–west coast travel out of Dulles. Thus there is no round trip nonstop service to Los Angeles available at Friendship. Friendship has felt reduction of 42 percent in the number of available seats, while the number of seats leaving Dulles has increased.[397]

(d) Many passengers wanting to travel have been unable to secure flights they wished. The Commonwealth of Puerto Rico, focusing on the New York–San Juan agreement market, has stated that in each of the peak months over 17,000 passengers were denied such service. During the 11-month period of the agreement, 68,985 passengers wishing service were unable to secure the flights they wanted.[398] During the 3 weeks between October 1 and 27, 1973, United placed 1,465 people on its waiting list in the four restricted transcontinental markets. At the same time the number of passengers flying in single stop or multistop service quadrupled, presumably because they could not secure nonstop places.[399]

(e) As a result of the agreements a considerable number of employees have been laid off. The Air Line Pilots Association estimated that United has laid off between 300 and 400 employees as a result of the agreements. The union estimated that United and Trans World Airlines have laid off more than 1,000 employees as a result of the capacity reductions.[400]

(f) The effect of the agreements on prices seems to have been negligible. There have been no price decreases since the capacity restricting agreements took effect: in fact, between the end of 1973 and 1974 prices rose nearly 20 percent. As Las Vegas' representative complained, the capacity restrictions were "not accompanied by any public benefit. All they did was decrease the schedule without decreasing or affecting the price. The public paid the same or more for less service." [401] This point is crucial for purposes of comparing capacity restricting agreements with proposals that would allow greater freedom to compete, particularly in price. Even if the more competitive policies that the subcommittee favors were to produce fewer flights—as well as fuller

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[396] Hearings at p. 1758 (testimony of Erle A. Taylor, director of aviation, Clark County, Nevada).

[397] Hearings at p. 1761 (testimony of Robert J. Aaronson, administrator, state aviation administration, Maryland Department of Transportation).

[398] *Capacity Reduction Agreements Cas*, Initial Decision, at p. 57 (Nov. 18, 1974), reprinted Hearings at p. 2047. See Ex. PR—R—1, dkt. 22908. American Airlines states that this exhibit is based upon an American study of "unaccommodated passengers" (those who could not obtain seats on the flights they wished. (See AA—SR—7, dkt. 22908).) Undoubtedly some of these passengers obtained suitable service on other flights. The Las Vegas experience suggests, however, that others, not finding a suitable flight, did not travel at all.

[399] Hearings at p. 2049.

[400] Hearings at p. 2150 (testimony of Roderic W. Gilstrap, first vice president, Airline Pilots Association).

[401] Hearings at p. 1757 (testimony of Richard P. Taylor, counsel for director of aviation, Clark County, Nevada).

planes—the consumer would be adequately compensated with substantially lower fares. The capacity restricting agreements, however, have given him the worst of both worlds.

4. Justifications for the agreements.

As Administrative Law Judge Seaver has found, the capacity restricting agreements have brought about harms that cannot be justified. Judge Seaver has rejected, as does the subcommittee, the following arguments advanced in an effort to justify those agreements.

a. The Need To Increase Carrier Profits

During the late sixties, the airlines and the Government overestimated the future growth in demand for air travel.[402] As a result of this over optimism, and a 3- to 4-year timelag between the placing of an order for aircraft and its arrival, the major industry carriers found themselves with too much equipment in 1969 and 1970.[403] Airline profits began to fall as this new equipment was committed to service, for the passengers were not available to fill it. The carriers argued strongly that capacity restricting agreements were needed to raise industry profits.

It seems unfair, however, to ask passengers rather than the airline shareholders to bear the burden of mistaken airline investment decisions. Ordinarily, in unregulated industries, if a firm overinvests, it will earn low profits, or no profit at all, until demand picks up or it can sell its excess equipment. Such firms are not allowed to agree with their competitors to charge higher prices or concertedly to withdraw equipment from the market. While the Federal Aviation Act requires the Board to maintain sound economic conditions in the industry, it does not require the Board to rescue firms from incorrect management decisions or to guarantee the industry that firms will not be allowed to go bankrupt.

Moreover, the risk of bankruptcy in 1970 may have been overstated. The industry as a whole earned a small, but positive return on investment of about 1½ percent. Returns during this downswing are roughly similar to those experienced during the downcycle of the early sixties (see tables 21, 24), when capacity restricting agreements were not allowed. The Board's staff noted that—

> * * * at the bottom of the cycle * * * the industry as a whole was not in jeopardy. Cash flow was at all time positive except in a few isolated situations which may have reflected management problems going beyond external events.[404]

Further, without capacity restricting agreements, as carriers begin to see large losses threaten, they can retire or sell part of their fleet. Indeed, American retired part of its BAC–111 and B–720 fleets. It

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[402] See Hearings at p. 1715 (testimony of Randall Malin, vice president, marketing and planning, American Airlines). Mr. Malin testified that the CAB and the industry generally predicted that 1969–72 growth in wide body jet markets would amount to 73 percent; whereas actual growth was only 18 percent. In 1968 United Air Lines estimated a yearly growth to 1975 of 11 percent per year. The Federal Aviation Administration estimate was 11.3 percent annual growth. Actual growth has averaged 5.1 percent. Comments of United Air Lines on subcommittee staff draft report at p. 2.

[403] See Hearings at p. 2240 (prepared statement of Herbert H. Moser, vice president, Merrill Lynch, Pierce, Fenner & Smith, Inc.). Mr. Moser states that the two key decisions that led to industry distress were the decision to buy 747's in April 1966 and to buy DC 10's in February 1968:

"It was not the equipment decision themselves that proved faulty, but the totally unconservative scope of the program. In effect, several carriers 'bet the company' in those decisions; so far, one has lost and another may yet. The leadtime on a new aircraft program simply exceeds one's visibility on economic prospects, and that fact, together with the high degree of operational leverage inherent in the airline industry, commands conservatism." Hearings at p. 2258.

[404] CAB, Bureau of Operating Rights, *The Future of the Board's Route Program*, notation 3320 (Oct. 2, 1972), reprinted in the separately bound appendix to the hearings.

has also sold 6 of its 16 B–747's; TWA has sold 6 B–747's to Iran.[405] Continental withdrew all four of its 747's from service. As American's witness testified in the capacity restricting agreement case:

> If a carrier were absolutely certain that the CAB would allow it to go bankrupt before it were given any relief, then I believe you would see some action taking place in eliminating marginal capacity. * * * I would say that it is my own impression that the carriers do not believe that they will go bankrupt without some action on the part of the Board. * * * In the situation that we are describing here where the Board would not care if several carriers just went out of business, I believe there would have to be more restraint on the part of management. Just mere survival would force management to take some action. They might still go bankrupt, but they would make a last desperate attempt to sell planes, cut capacity, abandon markets.[406]

While failure to allow capacity restricting agreements will lower carrier profits, it need not have forced any carrier into bankruptcy. Rather the *risk* of bankruptcy may be sufficient to lead carriers to withdraw excess capacity from overstocked markets and, more importantly to discourage carriers in the future from ordering too many airplanes. Indeed, the very point of using load-factor standards as a method for setting appropriate fares is to convince the carriers that, unless they fill their planes and refrain from ordering too much equipment, they will lose money and may go bankrupt. To allow the carriers to enter into agreements to restrict capacity may simply encourage overly optimistic investment decisions in the future.

Thus, Administrative Law Judge Seaver stated that he was thoroughly persuaded—

> * * * that if the carriers became convinced that come what may the Board will really adhere to the load factor standards it has adopted in the DPFI and give those standards time to accomplish what they were designed to do, the carriers can and will unilaterally reach optimal levels of capacity without capacity agreements * * *. Capacity agreements would have the opposite effect. The carriers would have no motivation for unilateral restraint * * * instead they would be motivated to increase capacity inordinately. * * * [407]

b. Eliminate Waste and Lower Fares

It can be argued that capacity agreements might be used to bring about lower fares. If the Board were able to mandate an appropriate level of service for every market, the argument states, it might bring about the fuller-plane low-fare service described in section II above. It would first insist that airlines so schedule their planes that they fill them on average 60 percent or 65 percent full. It would then reduce fares in light of the high profits that the airlines would then earn. In other words, it would operate a perfect cartel, eliminating excessive scheduling competition through mandate, and setting prices that just covered the cartel's costs.[408]

The major difficulty with this argument is that, while the Board might get some carriers to restrict capacity, the Board cannot force down fares. For one thing, the Board does not have the statutory

[405] Hearings at p. 1721 (prepared statement of Randall Malin, vice president, marketing and planning, American Airlines).
[406] Hearings at p. 1719.
[407] Hearings at p. 2041.
[408] See Fruhan, *The Fight for Competitive Advantage* (1972) which appears to recommend this course of action.

power to control scheduling.[409] And, the Board's efforts to entice other carriers into capacity restricting agreements generally failed. Unless *all* carriers enter into these agreements, it is unlikely that industry profits will rise high enough to lead to a fare decrease under DPFI standards. More importantly, capacity reduction agreements free airplanes from service on agreement routes and the parties to those agreements transfer those planes to other routes. As Delta testified:

> It is quite obvious that increased earnings in agreement markets add competitive strength for the agreement carriers versus the nonagreement carriers, and also free aircraft for heavier scheduling in nonagreement markets and allow more severe charter competition.[410]

This added competition on other routes simply inflicts losses on other carriers thus transferring the economic problem from one group of carriers to another, while *leaving average industry profits at the same level.* (Thus, since industry profits stay under 12 percent, fares never drop.) Although the Board's orders forbid the agreeing carriers to transfer aircraft, it is virtually impossible to ascertain whether such transfers actually take place. American Airlines, for example, increased its Chicago-Dallas frequencies from 6 to 10 round trips per day in June 1974. American argued that this increase was necessary to meet competition from Braniff and would have taken place regardless of the capacity-restricting agreements. The Board's Bureau of Enforcement agreed with American, but a reading of the Bureau's opinion reveals that it turns upon which side has the burden of proof—it is virtually impossible to know whether American did, or did not, shift capacity. Eastern's witness testified in the capacity-restricting case that freed capacity becomes an undifferentiated part of Eastern's fleet and is assigned to meet the needs for aircraft where and as they arise. Thus, Judge Seaver concluded that the evidence—

> * * * was conclusive—no one disagreed—that with the possible exception of the scheduling carrier itself, no outsider can trace and sort out the freed capacity from among the thousands of scheduling incidents of the operations of a large fleet of aircraft.[411]

In any event, if equipment is grounded, it stays in the rate base. Carriers are allowed to charge prices that cover the cost of investment in the grounded plane. Thus, again, industry profits never rise above 12 percent and fares never drop.

In sum, even if, in principle, a "perfect cartel" would fly the right amount of planes with higher load factors and lower fares, the Board as a practical administrative matter cannot directly control scheduling so as to bring this about. And, even if it controlled scheduling, competition might then take other forms such as flying bars or ice cream parlors. Or, the airlines might use up any excess profits in expenditures upon more complex equipment or higher executive salaries. Or, some excess profit might be wasted through lessened pressure to produce efficiently.

For all these reasons, it seems unlikely that capacity-restricting agreements will, in fact, result in higher load factors throughout the industry. It is still less likely that it will help push profits up to 12 percent. It is even more unlikely fares will fall. *As a practical matter, the capacity-restricting agreements have meant that those customers on*

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[409] FAA sec. 401(e)(4), 49 U.S.C. sec. 1371(e)(4) (1970).
[410] Hearings at p. 1734 (prepared statement of Richard S. Maurer, senior vice president and general counsel, Delta Air Lines).
[411] *Capacity Reduction Agreements Case*, Initial Decision at p. 93 (Nov. 18, 1974) (dkt. 22908), reprinted in Hearings at p. 2083.

capacity-restricted routes have not only paid high fares but have also received inadequate service. They have paid a fare sufficient to elicit frequent service in emptier planes; *they have received fuller planes and less-frequent service without any corresponding fare reduction.*

Among the alternative ways to raise load factors and to lower fares that have been discussed, even the present Board method—the use of load factor standards—is preferable to capacity-restricting agreements. That standard keeps fares low leading airlines to withdraw capacity unilaterally if necessary to avoid serious losses. Exactly this seems to have occurred in the markets between the east coast and Puerto Rico, for example. In those markets, fares are about 20 percent lower per mile than for similar distances elsewhere in the country. And load factors are about 30 percent higher. In 1973, for example, load factors on flights between Philadelphia and San Juan, Washington and San Juan, and Miami and San Juan, all were higher than 68 percent—though flights in these markets were not the subject of capacity-restricting agreements.[412] Allowing fare flexibility and open, more liberalized entry should have the same effect.

c. Capacity Restricting Agreements Are Necessary To Prevent Destructive Competition

Some carriers have argued that there is a unique feature—a "market imperfection"—of the airline industry that leads the airlines into ruinous scheduling competition. This argument—sometimes called the "S-curve" argument—states that a carrier, by increasing its number of flights in a market, will win more than a proportional increase in its market share. Conversely if it cuts its capacity, it will lose more than a proportional share of the market; thus carriers are constantly tempted to add capacity and highly reluctant to cut it. (Plotting capacity on a graph against market share produces an S-curve.) Carrier representatives also referred to the problem of the "prisoners dilemma": no carrier dares cut back the number of flights unless its competitors do the same; yet any carrier not cutting back, when its competitors cut back, would win an enormous market advantage. Thus, each carrier will be highly reluctant to cut capacity. In fact, TWA has pointed out that each carrier will continue to add capacity in a market as long as the incremental revenues that it earns will cover the incremental cost of the added capacity.[413]

It is important to realize that these arguments show no unusual "market imperfection" about the airline industry. Whether the S-curve exists is doubtful.[414] But even if the S-curve does exist to

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[412] Transworld Airlines exhibit TWA–R–7, at p. 2, *Capacity Reduction Agreement Case*, Initial Decision, Nov. 18, 1974, dkt. 22908.

[413] Hearings at p. 2022 ff. (prepared statement of Melvin A. Brenner, vice president, marketing and planning, Trans World Airlines).

[414] Professor Fruhan found the existence of the S-curve by noting that carriers with a comparatively large share of capacity in a market carry a disproportionate share of that markets' passengers, and carriers with a relatively small share of capacity carry a disproportionally small share of the passengers. See *The Fight for Competitive Advantage* pp. 126–139.

On the other hand James Miller and others have suggested that the larger than proportional market share does not flow from the fact that these carriers have a large share of capacity but, rather from the fact that a carrier with a larger market share may have been in the market longer. Miller found that measurements showing the result of a carrier's increasing, over time, its share of capacity in a market indicated that the carrier did not increase its proportional share of passengers to any significant extent. Administrative Law Judge Seaver found that "it is true that in a static condition over a period of time the dominant carrier who has the largest share of capacity in a particular market normally would enjoy an even larger share of the patronage in that market." But he went on to say, the relevant question is whether the carrier will be enticed to add capacity to obtain a more than proportional increase in the number of passengers carried. That effect, he found, does not exist. He concluded by stating, "the scheduling dilemma or market imperfection relied upon by the proponents does not exist." (*Capacity Reduction Agreements Case*, Initial Decision at p. 55 (Nov. 18, 1974) (dkt. 22908), reprinted in Hearings at p. 2045.

some degree, it shows only that carriers will be particularly reluctant—as they might be for a host of reasons [415]—to withdraw from the market so long as incremental capacity earns enough revenue to cover its cost. Similarly the "prisoners dilemma" problem is simply another way of stating that each individual carrier will be reluctant to cut back capacity unless its rivals do the same.

The reason that firms want to increase and not to cut capacity on particular routes (so long as incremental revenue covers incremental costs) to the point where overall profits are diminished is that there is overcapacity in the industry. This is no market imperfection, for the same situation would arise in any competitive industry in which overinvestment took place. The main difference between the airline industry and other competitive industries is that in other industries regulation does not inhibit *price* competition. Thus, in most industries, overinvestment is followed by a period of intense *price* competition during which competition can drive price down near incremental costs. Individual firms may have a hard time earning enough to cover their fixed costs; they may withdraw capacity from the industry; they may wait earning little or no profit until demand increases; they may, if their rivals do the same, raise prices. In unregulated industries, market forces are allowed to do their work, shareholders must suffer the consequences of incorrect investment decisions, and firms must withdraw capacity or let it lay idle earning low profits until demand improves. Evidently, the same type of experience occurs in the airline industry, but inhibitions against price competition simply lead the airlines to use scheduling competition instead.

The one interesting point that the capacity-restricting agreement experience suggests is that, given overcapacity, not even Board rules that prevent price competition can prevent that form of incremental cost pricing that the airlines refer to as "destructive competition" from taking place. *Thus, unless the Board is prepared to control capacity strictly throughout the industry by regulating schedules—a course that the subcommittee believes is practically, administratively, and legally impossible—excessive competition feared by the industry (if it occurs at all) would occur whether or not price is regulated.* Given this fact, if the fears of competitive excess were valid (and the subcommittee believes they are not),[416] it would be more sensible to allow the carriers to compete through price—which at least would have the effect of giving consumers the advantage of lower prices—rather than forcing competition to take the form of extra scheduled service elsewhere.

d. Capacity Agreements Save Fuel

The carriers have argued that the capacity restricting agreements after 1973 allowed significant fuel savings.[417] It is difficult to see, however, how the capacity restricting agreements were necessary to save fuel. Any fuel savings came about because the Federal Energy Office simply restricted the total amount of fuel that the carriers were allowed. Administrative Law Judge Seaver concluded that—

> * * * the agreement carriers have used all of the fuel that was allocated to them and all that was available to them since the allocation program started. * * *

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[415] Example, reasons related to their desire to have wide geographical coverage so that the carriers' name becomes well-known.

[416] See pp. 58–62, supra.

[417] The TWA representative testified that approximately 7 hundred million gallons of fuel has been saved, worth approximately $60 million per year. Hearings at p. 2155.

They would have done so in the absence of the agreement. So far as we know now they will continue to do so. Therefore, at this time and for the foreseeable future the agreement is not saving and will not save any aviation fuel.[418]

At most the capacity restricting agreements could have affected the pattern of service cuts developed as part of the necessary fuel saving program. The major airlines, through the use of the capacity-restricting agreements, cut significant amounts of service on long routes and thus maintained much of their service to small towns. Yet, testimony by Delta Airlines shows that unilateral cuts worked just as well. Delta [419] reduced service unilaterally, while maintaining service to both small communities and large. Delta's representatives stated "We have accomplished the same thing that they say capacity agreements have permitted them to accomplish without being a party to the agreements. We reduced flight schedules by about 13 percent, available seat miles by 8 percent, at a very substantial saving fuel." [420]

In any event, it is difficult for the Board to argue that capacity-restricting agreements were necessary to produce a more rational allocation of "fuel-shortage-induced" service cuts, for not only does Delta's experience suggest the contrary, but the Board made no effort to inquire of the carriers where, and how, they would make their cuts in the absence of the agreements.[421]

e. Conclusion

On the basis of the evidence submitted to the subcommittee, it is difficult to find justifications for capacity-restricting agreements sufficiently strong to outweigh their undoubted harm. They have injured local communities, travelers and airline employees; they have led to cuts in the level of service on many routes without allowing passengers on those routes a corresponding reduction in fares. Of course, price competition, too, might mean a reduction in service. But, price competition brings with it the increase in demand that flows from lower prices. Thus, to increase competition seems a sounder method than controlling schedules to achieve the objective of lower fares and fuller planes.

5. Procedural problems.

The history of the Board's treatment of capacity restricting agreements raises four significant procedural problems.

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[418] Hearings at p. 2094. Testimony from United's representative suggests that contrary to this statement, some small amount of fuel may have been saved in that United did not use its total allocation.

[419] Mr. Maurer of Delta added that their cuts took place despite "a highly competitive route structure on our principle routes. We compete in most cases with two other carriers. For example, in the New York to Boston to Florida markers we have three carrier competition: Delta, Eastern, and National. From Chicago to Miami one of our principle markets, we have three carrier competition: Eastern, Northwest and Delta. From Atlanta south to Florida there are five." Hearings at p. 1705.

[420] Senator Kennedy went on to ask "Did that bring about a reduction of service in small communities?

Mr. MAURER. Yes, we reduced service across the board. Gradually in the large markets and the small ones too.

Senator KENNEDY. It was across the board. You did not make a policy decision to eliminate the small towns before you did the big towns?

Mr. MAURER. As a matter of fact, it is easier to eliminate the more dense markets than it is the less dense, because you have to keep an adequacy of service in the smaller markets. To give you an example of a relatively small market, Atlanta/Savannah, which we serve basically with DC 9 and Boeing 727 aircraft, we came down one trip from 10 to 9—a 10 percent reduction—which was a considerable saving on fuel and direct operating costs. We eliminated something in the neighborhood of 13 or 14—aircraft from our fleet—we ended up with a better fleet of more efficient, more modern airplanes." Hearings at p. 1705.

[421] The Board did make such an inquiry when the FEA was considering an additional cut of 15 percent in the fuel allocation. This cut, however, did not take effect. The subcommittee's cursory review of the material sent to the Board suggests no reason for believing that unilateral cuts would have been more harmful than capacity restrictions.

a. The Failure To Hold a Hearing

The Board should not have approved extensive use of capacity-restricting agreements without holding a hearing. The agreements first took effect in 1971. The Board did not order a hearing until 1973. After the hearing, which concluded in late 1974, the administrative law judge ruled that the agreements were unlawful. The net result, as the Justice Department pointed out, is that—

> * * * for almost 4 years travelers in those markets covered by capacity agreements have been forced to serve as a profit generator for the major carriers on the basis of hastily approved intercarrier agreements whose justification, once open to cross examination and rebuttal, was insufficient to persuade an administrative law judge.[422]

A representative of the Maryland Department of Transportation was asked "what input does the community have in the development of . . . [the] agreements?" He responded:

> Only in the sense that we had an opportunity to submit written comments. I must say, as I indicated in my opening remarks, in the opening phases of the capacity agreements these comments were brushed aside by the Board as having no validity. The comments have since very graphically proved to be valid.[423]

The need for a hearing was particularly pressing for two reasons. First, the capacity-restricting agreements themselves constituted unprecedented steps contrary both to traditional antitrust law and the CAB's past precedents. The Board recognized that the first capacity-restricting agreement was a "limited departure from our normal policy." [424] Second, the dispute about the desirability of capacity restricting agreements was complex and factual in nature. Delta asked from the beginning what airplanes the agreeing carriers were prepared to sell. What employees were they preparing to lay off? Delta noted that unless airplanes were sold or employees laid off there would be, in fact, no industrywide cost saving. Rather, the agreeing airlines would simply take airplanes from restricting routes and ground them or use them elsewhere. In either case industry costs and fares would stay roughly the same; the agreeing carriers would make more money at the expense of other carriers, but the passengers on restricted routes would simply receive worse service for the same high fares. Delta's factual questions required a hearing to obtain answers. In fact once a hearing was held, many of Delta's fears were found to be well-founded.

While the Board granted a hearing, after 2 years, it nonetheless extended (without a hearing) the life of the capacity agreements so that they continued in effect while the hearing about their desirability was in progress. The upshot is that the public has suffered the effects of these agreements for 4 years before the Board could reach a final decision, after a hearing, as to their validity.

Two arguments might be made to the effect that a hearing was unnecessary. First, the statute itself—sections 412 and 444—which gives the Board the power to grant antitrust immunity does not specifically state that a hearing must be held. Nor do the Board's regulations mandate a hearing when the Board approves carrier

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[422] Hearings at p. 1746 (prepared statement of Donald I. Baker, Deputy Assistant Attorney General U.S. Department of Justice).

[423] Hearings at p. 1763 (testimony of Robert J. Aaronson, administrator, State Aviation Administration of the Maryland Department of Transportation).

[424] CAB Order 71-8-91 (Aug. 19, 1971) (dkt. 22908).

agreements.[425] Yet, the Board has the power to order a hearing in such cases.[426]

The act, in removing the Board's power to control scheduling, grants individual carriers greater independence in this area, making infringements upon this independence particularly serious steps that warrant caution. The CAB should not avoid a hearing in this type of case—a case involving a *major* change in Board policy with a major impact upon both the industry and the traveling public—simply by pointing to the fact that sections 412 and 414 do not themselves contain the word "hearing."

Second, the Board justifies its failure to provide a hearing by the "extreme financial distress that most of the air carrier industry [suffered] through the last 18 months." [427] In testifying as to why a hearing was not granted a Board official stated that profit levels "were getting to the state that the health of the carriers was a real problem." [428] Of course, the notion that an agency may take emergency action, without a hearing, particularly for reasons of health, is well grounded in the law. In the classic case of *North American Cold Storage Co.* v. *Chicago*,[429] the Supreme Court allowed the city to seize and destroy spoiled chickens on the ground that "food that is in such a condition . . . is . . . a nuisance of the most dangerous kind involving, as it does, the health, if not the lives, of persons who may eat it."

Yet, there is very little indication of any comparable "health emergency" here. In the industry's worst year, 1970, return on investment was still slightly positive (+1.6 percent). It was at just about the level reached at the low point of the industry's previous downcycle in the early sixties (see table 24, supra). And, by the time the Board ordered renewals of the capacity restricting agreements, profits had improved considerably. Considering the fact that, aside from the three major carriers, the rest of the industry opposed the agreements, local communities opposed the agreements, the Department of Justice and the Department of Transportation opposed the agreements, the agreements had signficant impact upon levels of service, and the decision embodied in the agreements represented a significant departure from past Board policy as well as an action directly contrary to the spirit, if not the letter, of the antitrust laws, the Board, in the subcommittee's view acted most unwisely, if not improperly, in allowing these agreements to take effect without a hearing.

b. Inadequate Attention to Anticompetitive Effects

The need for a hearing is underscored by the fact that approval of the agreements appears to represent a significant departure from the regulatory scheme embodied in the Federal Aviation Act. That act, while broad and general in scope, seems intended to bring about far

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[425] See 14 CFR, part 302.

[426] Not to have ordered such a hearing seems contrary to the spirit, if not the letter, of the act. The Federal Aviation Act is careful to specify elaborate rules requiring hearings before rates are changed. The obvious intent is to provide full opportunity for expression of various points of view before *significant changes as to fares* take place. It would obviously be improper for the Board to circumvent these provisions by, instead of having a hearing, allowing the carriers to agree themselves upon rates and then approving that agreement. The fact that capacity-restricting agreements concern scheduling makes a hearing more, not less, necessary for the Act shows a general intent to place scheduling matters outside the Board's control.

[427] *See* CAB Order 71-8-91 (Aug. 19, 1971).

[428] Hearings at p. 1784 (testimony of Stephen Gross, general counsel, CAB).

[429] 211 U.S. 306 (1908).

more competition than the CAB tends to allow. While one of the act's basic goals is to "foster sound economic conditions" in the industry, the Board is also instructed to consider "competition to the extent necessary to assure the sound development of an air transportation system." [430]

Moreover, in approving an agreement that would otherwise violate the antitrust laws, the Board is required to determine the effect on the public interest of an agreement for which approval is sought. Where an agreement has among its significant aspects elements which are plainly repugnant to established antitrust principles, approval should not be granted unless there is a clear showing that the agreement is required by serious transportation needs, or in order to secure important public benefits.[431] Under this standard, the capacity restricting agreements, in one administrative law judge's view—

> * * * would constitute per se violations of Section 1 of the Sherman Act * * *. Thus it would have to be shown that the circumstances justifying their approval were such that there existed a clear and present threat to the provision of air transportation service or caused some emergency which posed an immediate threat to the public interest and one which could not be overcome by less anticompetitive means.[432]

These principles are virtually identical to those laid down by the courts to govern agencies' exercise of power to grant antitrust immunity.[433]

These rules and standards make clear that the Board has the power, and the authority, to apply rather strict antitrust standards in reviewing requests of Board approval of carrier agreements. Yet, the Board, in the capacity restricting cases, appears to have departed from those rather strict standards. In the subcommittee's view, the Board ought not to have reached its 1971 decision or the decisions continually to extend the life of the capacity-restricting agreements, without greater effort than was made to explain either how approval of these agreements were consistent with the Board's previously articulated strict antitrust standards, or to explain and to justify departures from those standards in these cases.

c. Private Communications

The subcommittee has noted the Board's tendency to combine a practice of communicating privately with industry members with a failure to grant a hearing. Former Chairman Secor Browne, for example, has stated that throughout 1969 and 1970, representatives of the major airlines met with him privately in his office and complained about overcapacity in the industry.[433a] Moreover, the sub-

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[430] See FAA 102(d), 49 U.S.C. 1302(d) (1970).

[431] *Local Cartage Agreement Case*, 15 CAB 850, 853 (1962).

[432] *Capacity Reduction Agreements Case*, Initial Decision at p. 91 (Nov. 18, 1974), reprinted in Hearings at p. 2080.

[433] See *Federal Maritime Commission* v. *Svenska Amerika Linien*, 390 U.S. 238 (1968):

> Once an antitrust violation is established this alone will normally constitute substantial evidence that the agreement is "contrary to the public interest unless other evidence fairly detracts from this factor. . . .

See also *American Importers Association* v. *CAB*, 473 F.2d 168, 171-72 (D.C. Cir. 1972); *National Air Carrier Association* v. *CAB*, 436 F.2d 185, 194 (D.C. Cir. 1970). See also, North Atlantic Tourist case, 16 CAB 225-226 (1952); The Six Carrier Mutual Aid Pact, 29 CAB 158 (1959).

[433a] See Hearings at p. 1361.

committee has amassed evidence showing that private communications are by no means uncommon.[434]

The subcommittee does not believe that private communications as such are necessarily unlawful or improper. They may, indeed, play a necessary role in the Board's regulatory functions. Yet, as this report points out at p. 100–01 above, it is important that steps be taken to guarantee that significant information and significant arguments imparted in such communications be exposed for public view and possible refutation; that the Board members have similar contact with representatives of groups other than the industry; and that special care be taken that major policy decisions are made, not as a result of such informal contacts, but as a result of public hearings held on the record.

Given this background, it is no wonder that representatives of the communities felt that without a hearing, "we have not been able to get adequate consideration of the public interest factors that are involved." [435] In the subcommittee's view this background of private communications with industry members makes more serious the Board's refusal to hold full hearings on the subject of capacity restricting agreements.

d. Confused Standards

A review of the Board's antitrust policy by the Chief of the Bureau of Enforcement led him to conclude that the standards used by the Board for determining whether a particular agreement is or is not "in the public interest" are random or inconsistent. In discussing Board policy governing industry pooling agreements he states that, "probably the most frustrating thing about reading the Board's pooling cases is that one finds in them no attempt at the kind of narrow issue analysis or careful consistency which have the necessary preconditions to the creation of a legal dogma." [436] The Bureau of Enforcement concludes that, to date, although the Board has "broad antitrust duties," it has been reluctant to exercise them. And "the Board's limited view of its mandate" stems from "mere reluctance" and not "legal inhibitions stemming from any absence of power." [437] The explanation for this reluctance may lie in the Board's view, as explained in its brief to the Supreme Court in *Hughes Tool Co.* v. *TWA*,[438] that "the courts are better qualified than the Board to resolve questions of * * * antitrust violations, and the Board which has no expertise in the field, could only be expected to follow judicial precedent." In other words, the Board lacks expertise in the antitrust area—a fact that may explain both the Board's reluctance to embark upon antitrust investigations

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[434] As previously mentioned the five Board member's logs reveal 769 private meetings with industry representatives in 1974, supra, p. 92. And, of course, the *Moss* case itself considered the agency practice of meeting privately with representatives of the Air Transport Association before formulating rate policy. (*Moss* vs. *CAB*, 430 F.2d 891 (D.C. Cir. 1970). The subcommittee's hearings last November also showed that Board policy concerning minimum charter rates was formulated, and communicated to the industry, substantially through private conversations between industry representatives and staff members—staff members who, in turn, relayed through a variety of channels their impressions and views to the Board. See, generally, Subcomm. on Administrative Practice & Procedure of the Senate Comm. on the Judiciary, *Airline Charter Fares*, 93d Cong., 2d sess., staff report (1975).

[435] Hearings at p. 1763 (testimony of the Maryland Department of Transportation).

[436] Memorandum to the file by William Gingery, Director, Bureau of Enforcement, CAB on Board pooling policy at p. 5 (undated).

[437] Memorandum to Director, Bureau of Enforcement, CAB, from James W. Tello, senior attorney, Legal Division, CAB, on the subject of antitrust enforcement jurisdiction of the CAB at p. 3 (Feb. 12, 1975).

[438] 380 U.S. 248. (1965).

of its own and the Board's failure to develop clear, consistent, and stringent standards in the exercise of its power to grant immunity from the antitrust laws.

6. Recommendations.

The subcommittee has three basic recommendations in this area.

First, the Board should reaffirm its intent to use its authority to grant antitrust immunity to agreements that would otherwise be unlawful under the antitrust laws *only* in rare instances when a clear showing has been made that such agreements are absolutely necessary to fulfill an important transportation objective.

Second, appropriate liaison procedures should be developed with the Department of Justice by means of which the Board makes use of the Department's expertise to determine the probable effect of an agreement upon competition. Similarly, the Board should develop liaison procedures with the Department of Transportation by means of which it not only obtains the Department's views about an agreement's probable effects upon competition, but also makes use of the Department's expertise in determining whether an otherwise anticompetitive agreement is in fact necessary to fulfill an important transportation need.

Third, the Board should institute procedures, rewriting its regulations, to guarantee that full hearings will be held prior to the granting of Board authorization for any *major* change in policy that involves a grant of antitrust immunity. Exceptions from the principle of granting a hearing *prior* to the implementation of a new policy should be rare and allowed for only the most compelling reasons.[438a]

a. The Substantive Antitrust Standard

The subcommittee heard compelling testimony to the effect that no exemption from the antitrust law is needed. All parties recognize that the industry enters into many agreements that serve important transportation needs, such as interline traffic agreements, equipment interchange agreements, reservations and ticketing arrangements, and certain others.[439] The Department of Justice, however, pointed out that the antitrust laws forbid, not *all* agreements between firms, but only those agreements that are "unreasonable." For an agreement to be unlawful (unless it is of the unusual per se unlawful variety such as price fixing), it must both limit competition and be "unjustified." Thus, in the Department's view, legitimate agreements such as interline traffic agreements and so forth, would not be unlawful where they are needed to secure an important transportation objective.[440]

Nonetheless, the Department of Transportation has pointed out that the carriers feel a strong need for security from antitrust attack for planning purposes. They need to know which agreements they can, and which they cannot, use. To subject the carriers to full antitrust liability subjects them to a risk of suit from private parties and

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[438a] Legislation has been introducted by Senator Kennedy to impose requirements similar to these on proposed actions of all Federal agencies which would have a substantial anticompetitive impact. See S. 2028, 94th Cong., 1st sess.; 121 Cong. Rec. S 11666 (1975).

[439] See Hearings at p. 4 (testimony of Acting Secretary of Transportation Barnum).

[440] Of course, an agreement among competing carriers to divide slots at an airport with restricted space might prove to be unlawful provided that there was another, less anticompetitive way, of securing the necessary division. If so, the unlawfulness of the agreement might be highly desirable, for these agreements may themselves inhibit price competition among carriers.

the rather uncertain assurance that can be given through the Department of Justice "clearance" procedures.

For this reason, the subcommittee recommends that the Board, in passing on requests for antitrust immunity, uses the standard currently working with success in the field of bank regulation. Such a standard, modeled after the Bank Merger Act,[441] would make any agreement that would violate the antitrust laws unlawful unless "the anticompetitive effects are clearly outweighed in the public interest by the need to secure a significant transportation objective." The Board has adequate power to apply this standard. Indeed, the standard seems very similar to the standards announced in, for example, the Board's *Cartage* case.[441a]

If legislation is enacted, the subcommittee would recommend limiting antitrust attacks on such agreements to those brought by the Department of Justice, limiting the time within which those attacks might be brought, but allowing *de novo* court review of any such case, applying the above-mentioned standard. *De novo* court review would require a change in the law. Without new legislation however, the Board could implement the above standard in its own proceedings, and in doing so appropriately defer to the judgment of the Departments of Justice and of Transportation in their relative areas of expertise.

b. Liaison

The subcommittee recommends that the Board establish liaison procedures with both the Department of Justice and the Department of Transportation for use in developing staff positions and for reaching final decisions in cases involving requests for antitrust immunity. Informal liaison procedures will enable the Board's staff to have the benefit of the expert advice of both the Justice Department and the Transportation Department in these matters before the Board's staff takes a position in Board proceedings. In the proceedings themselves, both the Department of Justice and the Department of Transportation should be encouraged to intervene. Moreover, in reaching a decision, the Board should give considerable weight to the expert view of the Department of Justice insofar as that view concerns likely anticompetitive or procompetitive consequences of the proposed agreement. The Board should give equal weight to the expert opinion of the Department of Transportation in determining whether or not there is a significant transportation need that an anticompetitive action is necessary to satisfy.

c. Hearings

The subcommittee recommends that the Board develop standards for determining when hearings are to be granted on request for antitrust immunity. Obviously, given the fact that nearly a thousand requests for approval under section 412 may be filed in a year, and the fact that most of these are not controversial, it would be impractical and unnecessary to hold hearings in each case. Yet, only about 9 percent of these involve possible anticompetitive consequences. And, of those, presumably a still smaller number are controversial.

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[441] 12 U.S.C. sec. 1828(c) (1970).
[441a] 15 CAB 850 (1962).

As to these, the Board should ordinarily grant hearings prior to approving agreement. The Board's standards should clearly provide that a request for hearings in such cases by the Department of Justice or the Department of Transportation prior to the Board's approving an agreement will, as a matter of course, be granted. And, the Board's rules should provide that departures from the "prior hearing" procedure will be infrequent and will be allowed only in the case of a compelling showing of need for immediate action.

D. ENFORCEMENT AND CONSUMER PROTECTION

1. Introduction.

In addition to examining the Board's exercise of its three major statutory powers—concerning routes, rates, and antitrust immunity—the subcommittee examined how the Board has exercised its powers concerning law enforcement and consumer protection. That examination suggests that the CAB sets the same priorities in these latter areas as in the former: its first priority is to protect and develop regularly scheduled air transport service; efforts to obtain lower fares or better service for consumers play only a secondary role. That examination also revealed plausible claims of unfair treatment by the smaller, supplemental air carriers and instances of improper conduct by the CAB.

It should be kept in mind that the subcommittee did not comprehensively investigate all Board activity; it necessarily focused upon abuses described by witnesses. The subcommittee does not intend to disregard the many instances of fair, impartial CAB rule enforcement or the fact that the CAB has often successfully protected consumers. Nonetheless the subcommittee believes that its overall conclusion—that enforcement has been primarily aimed at protecting high-priced, scheduled service, not the consumer—fairly characterizes the Board's activities during the period under review.

The subcommittee's willingness to generalize on the basis of only a few instances flows in part from its discovery about how enforcement manpower has been allocated. CAB data shows that from January 1971 through October 1974 the Bureau of Enforcement spent about two-thirds of its field investigative man-hours trying to stop low-cost travel that may have violated CAB regulations. Such regulations, often technical in nature, restrict charter flights, prevent ticket discounting, and forbid unauthorized air transport. During that same period of time, however, the Bureau spent only 3 percent of its field investigative time investigating consumer complaints, including complaints about overcharging, bumping, and mishandled luggage (see table 30).

TABLE 30.—BUREAU OF ENFORCEMENT MAN-HOURS SPENT ON FIELD INVESTIGATIONS [441b]

Category of investigation	1971	1972	1973 [1]	1974 (through Oct. 3)
Charters	2,040	2,260	1,675	2,237
Ticket discounting	431	1,598	2,292	806
Cargo violations	599	190	1,775	513
Unauthorized air transportation	916	918	350	419
Integrity of broad processes	30	327	[1] 1,541	[1] 1,557
Discrimination	52	107	0	156
Consumer-oriented problems	0	135	501	63
Miscellaneous	54	25	0	0

[1] Audit function included as of September 1973.

Source: Prepared by Chief, Investigation and Audit Division, Bureau of Enforcement, Civil Aeronautics Board for General Accounting Office, Dec. 13, 1974. Hearings at p. 760.

That this allocation of the field work of enforcement personnel roughly reflects the importance that the Board attaches to these comparative types of activity is confirmed by the fact that all consumer enforcement activity must be channeled through the Bureau of Enforcement. The Board's Office of Consumer Advocate has "no enforcement authority" whatever. "When [it does] discover a violation of the act, or the Board's regulations, [it] then goes to the Bureau of Enforcement and makes a presentation or recommendation. The Bureau of Consumer Affairs has never sent investigators into the field; it has rather gone through the Bureau of Enforcement and asked their investigators to go out." [442]

The major weakness of the field work figures lies in the fact that they omit the nonfield work activities of Bureau attorneys. The subcommittee notes that very recently these attorneys have filed many more consumer, than charter, complaints.[443]

The impression that consumer activities play a secondary role is reinforced by the budgetary and manpower resources allocated to the Board's Office of Consumer Advocate. That office, organized in 1972, employs only 2 attorneys, 9 analysts, 3 administrators, and 9 other staff members.

Witnesses testifying presented further examples that confirm the fact that the Board spends too much of its time focusing on technical violations of rules that tend to inhibit low-cost transportation and not enough of its time developing and enforcing rules that will tend to protect the consumer. Yet, despite the obvious incentive for the Board to show that allocation of enforcement attorney time suggests different priorities than allocation of field investigation time, the Board has not done so. Moreover, the investigation revealed one serious incident concerning an attempt to suppress an investigation of airlines unlawfully failing to report political campaign contributions.

[441b] Table 30 summarizes the investigative time spent, by category, of certain investigations for the years 1971, 1972, 1973, and 1974 (through October). The investigative man-hours shown reflect only that time spent in field investigations where a CAB form 483 was prepared. Investigations handled, more informally, by correspondence or phone calls, are not accounted for in the summary since no such information was kept in regard to these types of investigative activity. Information on work performed by the field representatives stationed outside of Washington was not integrated into the workload control system until late in 1974 (memorandum from Chief, Investigative and Audit Div., Bureau of Enforcement, CAB (Dec. 13, 1974).)

[442] Testimony of the Chief of the Bureau of Consumer Affairs, Mr. Jack Yohe. Hearings at p. 1058.

[443] The Bureau of Enforcement states that "in fiscal 1975, 2 administrative complaints, and 1 court action, were brought to enforce the charter regulations, while during the same period, 30 complaints were brought to vindicate consumer rights including 21 involving alleged discrimination and 5 involving aircraft smoking rules." Comments of Bureau of Enforcement on staff draft, p. 2. The evidence presented above does not describe the allocation of man-hours or other resources.

It should be noted that the discussion that follows does not all relate specifically to the Board's Bureau of Enforcement, though it does concern the Board's enforcement activities. In its letter of April 10, 1975,[444] to the subcommittee, the Bureau of Enforcement indicates that many changes are being made in an effort to deal with some of the problems discussed here. This discussion does not reflect those changes.

2. Enforcement aimed at inhibiting charter service.

Supplemental air carriers complained bitterly about the extent to which the Board's enforcement activities are directed at them. It was claimed that approximately 50 percent of the Bureau of Enforcement's resources are directed to policing compliance with charter regulations.[445] The Board stated that 40 percent or more of its complaints involve charters,[446] and, as Acting Chairman O'Melia pointed out, the Bureau of Enforcement allocates its resources primarily in response to complaints.[447] Moreover, there is some evidence that in policing charter violations the Board tends to treat the supplemental carriers more harshly than the regularly scheduled carriers.

During the 10-year period 1965–74, selected *scheduled* air carriers were penalized a total of $51,000 in six separate CAB enforcement actions relating to the charter regulations. During the 5-year period, 1970–74, selected *supplemental* carriers were penalized a total of $184,000 in six actions—nearly four times as much in half the number of years.[448]

The BOE, however, states that, "although the Bureau has spent a great deal of its resources on charter enforcement, it is not true that the reason for this activity was any desire, * * * to discriminate against the supplemental industry." [449] And, it has produced figures showing that over the last 10 years, fines levied against supplementals are less than those levied against the scheduled carriers (see table 31).

TABLE 31.—SUMMARY OF CIVIL PENALTIES AND NUMBER OF CASES

[Fiscal years 1963–75]

	Number of cases	Penalties paid [in dollars]
1963	3	15,500
1964	5	7,750
1965	3	8,000
1966	1	2,500
1967	1	25,000
1968	3	150,000
1969	4	79,500
1970	4	76,500
1971	1	1,000
1972	15	202,150
1973	23	410,900
1974	28	478,000
1975	41	577,594

	[in dollars]
U.S.-scheduled carriers	507,150
Foreign-scheduled carriers	389,629
U.S.-supplemental carriers	339,540
Foreign charter carriers	246,000
Others (air freight forwarders, tour operators, etc.)	510,225

Source: Civil Aeronautics Board, Bureau of Enforcement.

[444] Hearings at p. 1133.

[445] See Hearings at p. 958 (testimony of G. F. Steedman Hinckley, chairman and chief executive officer, Overseas National Airlines, quoting the Chief of the Legal Division of the Bureau of Enforcement).

[446] Hearings at p. 1133 (letter to Senator Kennedy from James Weldon, Acting Director, Bureau of Enforcement, April 10, 1975).

[447] Mr. O'Melia stated that the BOE investigates many charter problems because of the complaints that "come in from travel agents and passengers." Hearings at p. 1376.

[448] Hearings at p. 959 (testimony of G. F. Steedman Hinckley) (emphasis added).

[449] Hearings at p. 1133 (Weldon letter of Apr. 10, 1975).

In any event the supplemental carriers certainly *feel* that the Board's charter rules are being harshly, and perhaps discriminatorily, enforced against them. This feeling arises out of the following three factors:

First, the Board's charter rules are undoubtedly strict and complicated. As previously pointed out, they so confine domestic travel that only a small fraction of air travelers can take domestic charter flights (see table 19, supra). While there are more international charter flights, international rules are similarly strict. For example, before a travel group charter can be flown, an application must be made to the Board.

For each application for each single flight there must be a transmittal letter, an option agreement, an agreement, a rider surety bond, a contract between organizer and participants, a passenger list, and several other documents, totaling 62 pages. The passenger name list must have all passengers numbered, alphabetized, identified as to whether they are on the main or standby list, identified as to whether they are departing or returning, identified as to address and telephone number, and there must be a verification of identity through a document such as a passport or social security card.[451] More importantly, if any flight is to be modified, even in minor respects—if it is to start a day earlier or return a day later or to serve an additional city or one fewer city or if a few people are to be added to the passenger list—then, rather than simply amending the previous filing, an entirely new application must be made. If these changes occur within 90 days of the flight's departure, the entire flight may have to be canceled because the advance filing requirements in the regulation cannot be satisfied. More recently the Board has required international flights to comply, not only with its own charter rules, but with equally complex and different European rules governing charter flights.[452] It is no wonder, that, although charter revenues represent only 3 percent of total airline revenues, charter *administrative fees* paid to the Board amount to 24 percent of the total fees that the Board collects.[453]

Second, the Board has enforced against the supplemental carriers rules that are essentially unworkable. The Board's rule governing affinity group charters, for example, requires transatlantic passengers to have been "members" of their sponsoring organizations for 6 months prior to flight. Since millions of potential passengers would like to take advantage of low-charter fares, and since they cannot understand why the Board has promulgated rules designed to prevent them from doing so, many have little compunction about trying to travel on such flights despite the lack of 6 months prior membership. As Mr. Hinckley testified, many people may sign false affidavits affirming 6 months prior membership. He added,

> I would go so far as to say I think there are members of the clergy, or congregations of churches, which without the slightest feeling of guilt [would sign], because they know they are getting cheated by the CAB which is trying to keep American citizens off low-cost transportation when there is no justifiable reason for doing so.[454]

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[451] Hearings at p. 566 (testimony of William A. Hardenstine, senior vice president of sales, World Airways).
[452] Hearings at p. 954 (testimony of G. F. Steedman Hinckley, chairman and chief executive officer, Overseas National Airways).
[453] Hearings at p. 566 (testimony of William A. Hardenstine, senior vice president of sales, World Airways).
[454] Hearings at p. 943 (testimony of G. F. Steedman Hinckley, chairman and chief executive officer, Overseas National Airlines).

The procedures used by the Board to enforce the 6-months rule are apparently unreasonable. Any time before the flight takes off, the Board may send the charter carrier a telegram stating that the Board has received a complaint that one or more passengers are not bona fide members of the group.

Despite the fact that the supplemental airlines obtain certificates of 6-month membership signed by the charter organizers, and often affidavits or statements from every member of the group as well, some travelers may sign false statements. It is then difficult, if not impossible, for the airline to know who, if anyone, has done so. If the airline receives a last minute BOE telegram, it must decide whether to cancel the flight losing thousands of dollars, or to fly the plane running the risk of a CAB fine or revocation of its operating authority. Supplemental carriers also claim that, as a practical matter, in a later enforcement proceeding, the only issue is whether or not there were illegal passengers on the flight, and the fact that the supplemental carrier might have made every possible human effort to prevent unlawful passengers from flying is irrelevant.[455] The Bureau of Enforcement strongly denies their charge stating that all complaints "are grounded on the allegation that the carrier 'knew or should have known' that the flight was unlawful." [456] Nevertheless, given the widespread rule violations, charter operators must reasonably fear that, after the arrival of a telegram, they will be unable to win a subsequent enforcement proceeding despite efforts to keep illegal passengers off their flights.

Even if a restrictive charter policy were wise—and in the subcommittee's view it is not—to create a set of rules that tends to make everyone a rule violator is fundamentally unsound policy. Enforcement under such a system must become selective; and selective enforcement allows the exercise of uncontrollable power. Suppose, for example, that the Board wishes to stop a supplemental from obtaining a new certificate that will allow it to extend low fare service, but that it does not wish to deny the license on the grounds of the proposed low price. It need only refuse to allow the flight on the basis that the carrier has violated other charter regulations in the past and therefore is not "fit." Conversely, when the Board favors a new proposed service, it need mention nothing about the carrier's past rule violations. The result is a potentially arbitrary and unreviewable exercise of Board policymaking power. The fact that the Board has recently recommended against allowing Laker Airways the right to offer regular transatlantic flights at a 1-way fare of $125 (regular scheduled fare is $292 to $382 depending on the season) on the ground that Laker has admitted to past violations of charter rules shows that this danger is far from hypothetical.[457]

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[455] Hearings at p. 943. Until recently, the Board, according to Mr. Hinckley, would not even tell the supplemental airline the source of the complaint that led to the sending of the telegram. This made it virtually impossible for the supplemental airline to try to check to see whether in fact illegal passengers were on the plane.

[456] Comments on staff draft report p. 5.

[457] Compare *Cox v. Louisiana*, 379 U.S. 536 (1965), 379 U.S. 559 (1965), in which the Supreme Court refused to allow the state to enforce an ordinance requiring a parade permit in order to stop a civil rights demonstration. Since other parades had been allowed without a permit, suddenly to insist that this rule be enforced would have allowed selective enforcement; in fact the permit rule was being used to enforce a state policy that had nothing to do with permits, but, rather was hostile to civil rights demonstrations. The parallel with the Laker case is striking.

The Bureau of Enforcement, commenting on the supplementals' claims of unfair treatment, states:

> While the Bureau does not disagree that the current charter rules are unrealistic in today's marketplace, we cannot turn our backs on such rules and refuse to enforce them. Indeed, perhaps the best way of insuring change is to vigorously enforce the current rules and thereby highlight those rules where change is necessary.[458]

If this means that the Bureau enforces the rules with unusual vigor in order to force their abandonment, it sounds highly undesirable. But, in any event, the subcommittee agrees strongly that change is necessary, for the combination of overly strict rules with strict enforcement is intolerable from both substantive and procedural points of view.

Third, the Bureau of Enforcement decides how to allocate its investigatory resources primarily upon the basis of industry complaints. Acting Chairman O'Melia, the former head of the Bureau of Enforcement, stated that the Board has "an awful lot of investigations of charter problems because that comes in from travel agents and passengers that are dissatisfied." [459]

The head of one of the supplemental airlines has testified that the high visibility of affinity charters "means that they draw more fire from travel agents who want that business, or feel that by destroying a charter flight they will pick up individual ticketed business. Moreover, the vague and ambiguous regulations assure a disgruntled travel agent happy hunting ground." [460]

Since competitors, or business associates, are far more likely to complain to the Board than the ordinary passenger, and since a competitor is far more likely to complain about a rival's fare that is too low than a rival's fare that is too high, it is not surprising that reliance upon complaints as a basis for launching an investivation has led to a resulting bias against low-fare travel. However, the CAB's duty to protect the public interest requires more than setting disputes among the few who are well represented. It must go further and seek to aid the many who are injured but who do not bother to sue and the many more who are deprived of opportunities which they never envisaged.

3. The improper use of informal procedure to exclude a new competitor: the case of Air Europe.

The history of the Board's treatment of Air Europe shows how it used "informal" enforcement procedures, disregarding elementary standards of fair practice, to prevent a specific airline from offering low-cost flights.

Air Europe proposed to fly regularly scheduled service from Tiajuana, Mexico, just south of Los Angeles, to Luxembourg, beginning September 1, 1974, at a summer round trip price of $539 round trip (compared with the regular Los Angeles summer round trip price of over $1,000). Air Europe's lawyer reviewed these plans with the Board's staff in April 1974.

He said that the flights, which had been authorized by Luxembourg and Mexico, did not require further CAB approval because they did not constitute "foreign air transportation" within the meaning of

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[458] See Weldon letter of April 10 at p. 17. Hearing at p. 1133.
[459] Hearings at p. 1375.
[460] Hearings at pp. 958-59 (testimony of G. F. Steedman Hinckley, chairman and chief executive officer, Overseas National Airways).

the Act.[461] (The Act defines "foreign air transportation" as transportation between "a place in the United States and any place outside thereof," [462] and Air Europe proposed to supply transportation only between terminals *both of which* were outside the United States.[463])

Some members of the Board's staff, however, believed that the air service between Tiajuana and Luxembourg constituted "foreign air transportation" between a place in the United States and a place outside the United States. (They noted that the definition of "foreign air transportation" is "the carriage by aircraft of persons * * * between * * * a place in the United States and any place outside thereof whether such commerce moves wholly by aircraft or partly by aircraft and partly by other forms of transportation." [464] In these staff members' view Air Europe was, in fact, transporting passengers between Los Angeles and Luxembourg.)

Throughout the early summer of 1974 Board staff members met with staff of the Department of Transportation and the State Department, urging those two agencies to use their influence and legal power to stop Air Europe from flying. On July 19, 1974, the Director of the CAB Bureau of International Affairs sent a memorandum to the Board recommending that the Board send to the Secretary of Transportation and to the Secretary of State requests to withhold authorization for Air Europe to fly over the United States. The memorandum and letters argued that the Air Europe arrangement was "a subterfuge" in large part because "the arrangement is subject to restrictions imposed by Mexico which preclude the sale of transportation in Mexico to Mexican nationals."

The Board, without public notice or hearing, approved the sending of the letters. Air Europe was given no opportunity to learn of, or to rebut, the arguments and factual statements made by the staff—either before the Board or in its meetings with the Department of Transportation and Department of State. Had Air Europe been given such opportunity it would have argued that the staff was not only legally wrong, but also factually wrong about the most important fact cited: Air Europe was not "subject to restrictions imposed by Mexico which preclude the sale of transportation in Mexico to Mexican nationals."

The failure of the Board to offer Air Europe an opportunity to meet and to rebut the staff's argument would not have been so serious, had the Board and its staff not, at the same time, issued statements to the press. On July 15, 1974, an article in the *Los Angeles Times* quoted a CAB staff officer as stating that Air Europe's operation was a "subterfuge to get around U.S. authority." *Aviation Daily* on July 24, 1974, stated that "a Board official called the airline a 'pirate operation' that is using Tiajuana as an 'escape hatch * * * to circumvent U.S. laws.'" The *Los Angeles Times* on July 30 reported that the CAB was trying to prevent the Air Europe operation and it quoted a CAB staff official as describing "the Air Europe scheme as a

[461] Section 402(a) of the Federal Aviation Act, 72 Stat. 757, 49 U.S.C. 1372, provides that "no foreign air carrier shall engage in foreign air transportation unless there is in force a permit issued by the Board authorizing such carrier so to engage."

[462] FAA sec. 101(21)(c), 49 U.S.C. 1301.

[463] Section 1108 of the Federal Aviation Act requires Board permits for transportation across the United States by foreign carriers traveling between two foreign points. But, those permits must be issued in accordance with the terms of applicable United States treaties. The International Air Service Transit Agreement would seem to have required granting Air Europe permission to overfly the United States proved that it operated between foreign points.

[464] Section 101(21).

'cancer'." *Aviation Daily* on July 31, stated that "a CAB spokesman told the Daily 'we are going to find some way' of preventing Air Europe from flying out of Tiajuana." The *New York Times* on August 7, reported that "the United States Government * * * is trying to abort the enterprise;" it states that a CAB official "asserted 'this is nothing more than a pirate operation designed to get around the law; we will stop them one way or another.' " The August 12 issue of *Aviation Week and Space Technology* reported that Government officials including representatives of the CAB "vehemently opposed the Air Europe service." It added that "another approach being considered by the U.S. is boarding a U.S. marshall on the flight in Tiajuana and forcing the aircraft down in U.S. territory."

A November 5 article in the *Los Angeles Times* quoted the letter from Acting Chairman of the CAB Whitney Gillilland to Transportation Secretary Claude Brinigar.[465] The Chief of the Board's Bureau of International Affairs acknowledged responding to press inquiries about the Board's letter to the Department of Transportation, but he denied knowing who was responsible for the statements that led to the article quoted above.[466]

As a result of the letter to the Department of Transportation, and the press publicity, Air Europe was forced to abandon its plans. As Air Europe's lawyer stated "you cannot sell tickets when travel agents are reading that the United States Government is considering boarding U.S. marshals on the airplane and forcing the airplane down at gunpoint. No travel agent who has a responsibility to his clientele is going to put them on an airplane that can be hijacked by the U.S. Government." [467] He testified that Air Europe's "financial resources were completely exhausted preparing for 2 years this operation—the marketing the advertising, the aircraft, the crew, every penny they had $400,000 spent—and, they are blocked; they cannot go forward." [468]

As a practical matter Air Europe was stopped by secret Board action combined with public press statements. Had Air Europe had an opportunity to meet the claims made against it, it would have been able to argue that the important factual allegation about restrictions on Mexican nationals was false.[469] Instead, this statement was used without challenge to formulate the Board's position; it was used in letters to the Department of Transportation and the Secretary of State; it formed a basis for discussions with staff members of the three agencies over the summer, and as of February 26, 1975, Board members themselves still believed it to be true.[470] Alternatively, if the Board's actions and allegations had not been discussed with the press, Air Europe might have remained in business until it was given an opportunity to answer the charges against it.

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[465] Letter from Robert M. Beckman, counsel, Air Europe International to Robert Timm, chairman, CAB, dated September 5, 1974, appended to response of the CAB to the subcommittee questionnaire, questions 44–46, reprinted in the separately bound appendix to the hearings.

[466] Hearings at pp. 1379–80.

[467] Hearings at p. 948.

[468] Hearings at p. 947.

[469] Thomas Heye, the Board's General Counsel stated in a deposition taken by Air Europe that the statement about restrictions on the sale of tickets to Mexicans in Mexico is "a fact that subsequently turned out to be inaccurate."

[470] Member West testified that "the matter never has come before the Board that I am aware of, in any formal way, because the thing never did get off the ground. It was, as I recall, set up a bit strangely, in that it was operating out of Tiajuana, I believe it was, but restricted the sale of tickets to within the United States." Hearings at p. 1380.

The Board has now recognized that staff statements to the press in a case such as this are improper.[471] It has not yet realized, however, that the underlying procedural defect was not so much press statements as it was the failure to grant Air Europe some form of hearing—some chance to learn of, and to rebut, the claims against it—before taking action that significantly affected air travelers and airlines.

The Board ought to have asked its Bureau of Enforcement about the legality of Air Europe's operations and for an enforcement recommendation. It ought to have decided itself—after hearing both sides of the argument—whether Air Europe's operations constituted "foreign air transportation" within the meaning of the Act. If it decided not, Air Europe might have continued its operations free of CAB staff harassment. If it decided so, Air Europe would have ceased operations. (Or, if it did not, the Bureau of Enforcement would have taken appropriate steps. It might, for example, have asked for a court injunction under FAA sec. 1007.) [472] Instead, the Board proceeded without benefit of any study by, consultation with, or recommendation of, its Bureau of Enforcement.[473] It held no hearings. It heard only one side of the argument. And, it enforced its will with finality through the device of making its intentions publicly known It substituted administrative force for the orderly processes of reasoned decisionmaking that constitute a system of administered law.

The subcommittee is not suggesting that the Board hold a full hearing before taking any decision, no matter how minor. But, when a matter is, as the Board recognized, "the first of its kind," when it is important, when factual and legal issues are hotly disputed, and when the Board's action will, as a practical matter, have final effect, the Board should devise some form of adversary proceeding to acquaint it with the basic arguments before it makes a decision. The Board need not always hold full-blown hearings. To promote speed and efficiency, it may sometimes be necessary to rely upon informal hearings; in other instances, a consumer advocate might be asked to present the consumer's point of view at informal meetings. But, the subcommittee has found far too often—in the case of "minimum charter rates,[474] many route cases,[475] even basic route policy,[476] and now Air Europe—that the Board follows a practice of holding hearings only after a basic decision has been taken, or it makes no effort to devise an adversary proceeding at all.

Just what form of adversary proceeding fits a particular matter—just how the conflicting administrative interests in efficiency and fairness should be balanced in a particular case—should be to some extent within the Board's discretion. The Board is in the best position to know the relative importance of different decisions, what

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[471] Hearings at p. 1379. In November 1975, the staff prepared an elaborate legal memorandum supporingt its position. It has made that memorandum available to the subcommittee. An examination of it suggests that the legal question of whether Air Europe's operation fell within the definition of foreign air transport is highly uncertain.

[472] There would have been no jurisdictional problem, for the president of Air Europe was a resident of Los Angeles.

[473] See Hearings at p. 1133 (letter from James L. Weldon, Jr., Acting Director, Bureau of Enforcement, CAB, to Senator Kennedy, dated April 10, 1975). The Bureau writes that it "was never consulted on or requested to take action with respect to the Air Europe operation." The only action taken by the Bureau was the preparation of a legal memorandum on the jurisdictional question. The Bureau adds that "the issue to be decided was whether the operation would constitute 'air transportation' within the meaning of the Act. This issue is necessarily fact sensitive, and we were never able to conclude, on the facts as we had them, that the operation was illegal."

[474] Subcommittee on Administrative Practice and Procedure of the Senate Committee on the Judiciary, Procedures Relating to Minimum Charter Air Fares, staff report, committee print, (93d Cong., 2d sess.(1974)).

[475] Pp. 82-83, supra.

[476] Pp. 86-87, supra.

form of procedure will best provide a fair opportunity to present evidence and argument and, when a proceeding must be held if it is to affect a decision. But, unless the Board begins to develop a range of formal, and informal, procedures that will assure a fair, comprehensive presentation of views before a decision is made the public will continue to demand ever more elaborate, formal, statutory safeguards. Unless the Board itself uses commonsense in providing the rudiments of fair procedures, Congress will respond with procedural safeguards that may be far more elaborate than necessary for the ordinary case, but which are designed to stop the types of abuse found in the minimum charter rate case, in the Board's route procedures, and in the *Air Europe* case as well.

The Board has now recognized that at least some of its actions in the *Air Europe* case were improper, but it has done little to correct the problem.[477] It has not determined how, or why, descriptions of the Board's intent appeared in the press; it has made no effort to reprimand staff members who might have violated Board rules; it has made no serious effort to resolve the jurisdictional question at issue; nor has it disowned the press statements that appeared. In fact, during a court hearing held as part of an effort by Air Europe to force the Board to disown those press statements, Federal District Judge Gerhard Gesell asked the CAB counsel, "Have the defendants (the CAB) given you any reason why they cannot simply and immediately disown these false reports about their work?" The counsel replied "that they would not." Judge Gesell stated:

> What this general counsel says is nonsense. If the Board wanted to do something about this, they could. I can't order the Board to. But I think it would serve to place this controversy in somewhat more reasonable perspective. * * * But that is purely a matter of decency, and not a matter of law. * * * I again express * * * the feeling I have that this may be a situation where the Board would be well advised to straighten out the situation in a simple statement that wouldn't in any way prejudice the Board and would clarify some of the problems that Air Europe is encountering because of this flood apparently of inaccurate publicity and that the Board has perhaps some obligation there to consider it as a human matter because they acted on false information. That that is not a legal matter. It just seems to me that that would be a sensible thing for the Board to consider.[478]

As of the date of the hearing before the subcommittee, the Board had issued no statement either denying or retracting the press comments about Air Europe made in its behalf.

The statistics concerning the Board's use of its manpower, the documented complaints of the supplemental airlines, and specific instances such as those of Air Europe and Laker Airways' transatlantic application, together indicate that the Board has concentrated its enforcement efforts upon stopping improper low-cost travel; it has done so persistently, and not always fairly. The result is public criticism of, and resentment against, the Board's enforcement policy—a reaction that is easy to explain. Basically, the public wants low-cost travel; several airlines wish to provide low-cost travel; the Board's rules inhibit the provision of low-cost travel; the public is

[477] An indication of the needless secrecy that surrounds the CAB's work is provided by the fact that most of the documents in the *Air Europe* case were classified, "For Official Use Only" and the Board's staff would not make them available, even to Air Europe's counsel, for many weeks. The Board has asked the subcommittee not to make them public and the subcommittee will not do so, though, after reading the documents, the subcommittee can determine no conceivable reason why they ought to be withheld from the public.

[478] This statement of Judge Gesell is contained in his opinion in Civil Action 74-1400, Dec. 6, 1974, at pp. 20-24.

willing to violate those rules in order to obtain low-cost travel. Thus strict enforcement of the Board's rules works hardship on the airlines, creates unfairness, and injures the public. The solution is not necessarily lax enforcement of Board rules, but, rather, modification of those rules to bring them into line with what the public wants and the marketplace wishes to provide.

4. Failure to devote enforcement resources to consumer problems.

While the Board has devoted over 60 percent of its enforcement resources to enforcing rules against low fares, it has devoted comparatively few resources to protecting consumers from overcharges, overly complex tariffs, lost baggage, bumping, and a host of other problems.

According to one student of the subject, "about half of all air travelers have paid too much for their flights." [479] These overcharges result from two related problems.

First, airline fares are extraordinarily complex (see p. 119, note 323, supra), airline ticket agents often overcharge out of confusion. In May 1972 *Consumer Reports* announced that it had been overcharged for 20 of 31 tickets that it had purchased for connecting service for which through ticket prices had not been published.[480] Prompted by this report and a number of U.S. senators, the CAB reviewed 612 connecting tickets; it found 159 overcharges (26 percent) and 34 undercharges (5 percent).[481] Witnesses maintained that significant overcharging is still occurring.[482]

Second, the airlines appear to make little effort to explain to potential customers how they can achieve their travel objective at the lowest possible fare. To the contrary, American Airlines' Training Manual, for example, teaches its sales personnel that "American's basic sales policy is to sell the highest priced product that the customer is willing to buy to obtain the service he prefers." [483] In case the customer is tempted to shop around, airline sales personnel are trained to induce him to buy at once. For example, one TWA training manual states

> There is a technique * * * that uses a good direct benefit for the caller which induces him to buy *now*. Can anyone guess what it is? Answer: Seat scarcity. It is a great convincer. Is it a lie? Answer: No. How many seats can you check on PARS [TWA's computerized reservation system] maximum? Answer: Seven. [TWA's computerized system in answer to the question "how many seats are left?" answer "Seven" if there are seven *or more* seats left on the airplane. If there are fewer than seven seats left, it shows the number left. Thus, there might be 50 seats left on the aircraft, but the computer will show "seven."] Is seven a few, answer: yes. Stay away from the number seven unless specifically asked or it will get repetitious and sound like a canned statement. Just say, "a few." If they ask "how many?" say, "I'm only showing seven," or whatever is on the screen. [484]

To put the matter bluntly, TWA instructs its sales people to lie—to tell customers that there are only a few seats left when the plane may be nearly empty.

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[479] Hearings at p. 843 (prepared statement of Jens Jurgen Wegscheider, Travel Information Bureau).
[480] Hearings at p. 850 (an article from Consumer Reports, May 1972, submitted for the record by Mark Silbergeld, attorney, Consumers Union).
[481] Hearings at p. 864 (an article from Consumer Reports, June 1973, submitted for the record by Mark Silbergeld, attorney, Consumers Union).
[482] See Hearings at p. 825 (testimony of Jens Jurgen Wegscheider, Travel Information Bureau, and Patricia Kennedy, tariff analyst, Aviation Consumer Action Project).
[483] American Training Outline No. 4–7A, p. 2. TWA's Marketing Training Manual at p. 501, 53.44 states "Don't go out of your way to push a lower fare."
[484] Id., p. 501, 53.90 (sentences in brackets added by subcommittee).

Given this sort of sales policy, and the enormous complexity of the tariffs involving special discount fares, it is hardly surprising that many passengers travel at fares considerably higher than those to which they are entitled. However appropriate it is for firms in an unregulated industry to tell their salesmen to hide the existence of a cheaper product, or to mislead customers to prevent their shopping around, the subcommittee believes such tactics are highly improper, especially in a regulated industry in which the ability of firms to gain a competitive advantage through price competition has been significantly circumscribed by Government regulation. To the subcommittee's knowledge, however, the Board has never examined the airlines' sales techniques; it has not read through their training manuals; nor has it seen that airline sales personnel are instructed to try to fit the lowest, not the highest, possible fare to the air travelers' needs.[485]

One witness provided a further example of the CAB's lack of interest in overcharges. On January 17, 1975, the CAB approved a "bicentennial excursion" fare that offered 20–25 percent discounts for transcontinental flights.[486] Thousands of travelers who purchased tickets prior to January 17 for flights that departed after January 31 could have obtained a 20–25 percent refund simply by turning in their tickets and repurchasing the same ticket under the bicentennial excursion plan. Did anyone explain this possibility to these passengers? No. Not the travel agents, not the airlines, and not the CAB. It would, of course have been administratively difficult to contact each of these thousands of people, but the CAB insists upon exactly this procedure in cases in which consumers have purchased tickets that have increased in price between time of purchase and time of flight.[487]

Another vexing problem that needs more attention is the dishonoring of confirmed reservations on oversold flights. Over 100,000 passengers were "bumped" last year from flights for which they held reservations, according to the CAB's own statistics.[488] Obviously, the unexpected denial of boarding at the gate, often too late to make other arrangements, can result in tremendous inconvenience and disruption to the traveler who has relied on a confirmed airline reservation in making important business or personal plans. The Board has largely taken a hands-off approach, although its regulations do require that bumped passengers be given denied boarding compensation unless alternative transportation can be arranged to get the passenger to his destination within 2 hours of his original arrival time (4 hours for international flights). Although more than 10 percent of all consumer complaints received by the Board concern bumping,[489] little effort has been made to improve the situation.

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[485] TWA reservation agents are also instructed to answer an inquiry about competing carriers schedules by first quoting the most inconveniently timed competitors flight and then trying again to sell TWA. Agents are also trained in quoting schedules for routes over which TWA does not have nonstop service. They are told not to mention the fact that the TWA flight is connecting and not to mention that another carrier has nonstop flights unless asked explicitly. Furthermore in selling interlined space agents are instructed to "determine if TWA can participate in the routing and then select a routing that will give TWA the longest haul." TWA Marketing Training, p. 501, 53.66–68.

[486] CAB Order 75–1–72.

[487] Hearings at p. 844 (prepared statement of Jens Jurgen Wegscheider, Travel Information Bureau).

[488] CAB report on passengers denied confirmed space, calendar years 1974 and 1973 (March 1975).

[489] CAB press release 75–35 (Feb. 19, 1975).

Bumping occurs as a result of the airline practice of overbooking—that is, selling more confirmed seats for a flight than the plane will actually hold. Industry spokesmen contend that this practice is necessary to offset "no-shows"—passengers with reservations who do not use them because of misconnections, failure to cancel, or other reasons. Consumer groups contend, on the other hand, that there are better approaches to the no-show problem; but even if overbooking were necessary, they say, passengers should be warned in advance of the risk of being bumped and should be given adequate compensation when it happens.

One possible alternative to overbooking, pioneered by Eastern Air Lines, does appear worthy of consideration. Under Eastern's "Leisure Class" concept, the passenger may obtain a ticket with a conditional reservation at the normal coach fare. If space is available on the flight, the leisure class passenger is accommodated, either in the first class or coach section; but if the flight is full, he is given a payment equivalent in amount to denied boarding compensation. In effect, this is an option given to the passengers themselves to be eligible for possible bumping and compensation. Passengers whose travel needs require firm assurance that they will be accommodated can opt for a normal reservation. Using this system as a substitute for overbooking, Eastern has established by far the lowest bumping record of any major airline.[490]

Whatever may ultimately prove to be the best solution to the no-show problem, the extent and consequences of the bumping practice call for responsible CAB attention to these questions at an early date.

The subcommittee is concerned not only by the apparent inadequacy but also by the slowness of response by the CAB to consumer complaints, particularly in contrast to the speed with which it deals with charter rule violations. According to consumer witnesses, even relatively simple complaints encounter inordinately long delays before Board action is taken.[491] In one extreme case, a complaint against an airline for unlawfully discriminating in admission of selected passengers to its "VIP" club facilities took 8 years (and the threat of a court suit) to resolve.[492]

Other problems that have been the subject of Board rulemaking procedures for extended periods of time include liability for lost baggage and the carriage of animals. The rules governing liability for lost and damaged luggage allow carriers to limit their liability to loss caused by negligence and to impose a maximum liability of $500. It is difficult to understand why airlines should be able to impose these limits or why they should not be strictly liable for lost or damaged luggage—common carriers were strictly liable under common law.[493] After all, it is far easier for airlines to prevent the losses in the

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[490] CAB report on passengers denied confirmed space, footnote 489, supra. Whether bumped passengers may also sue in court for damages is presently the subject of *Nader* v. *Allegheny Airlines*, 512 F.2d 526 (D.C. Cir.); *cert. granted* 44 U.S.L.W. 3270 (U.S. Nov. 11, 1975).

[491] Hearings at p. 837 (prepared statement of Patricia Kennedy, tariff analyst, Aviation Consumer Action Project).

[492] Hearings at p. 826 (letter from Reuben B. Robertson, III, counsel for Herbert A. Goldberg, to the Civil Aeronautics Board, dated Jan. 21, 1974); p. 829 ("How to Join Airline Club: 8-Year Wait," Washington Star-News, Jan. 27, 1974).

[493] In the 19th century common carriers were strictly liable for lost and damaged luggage, and the system appears to have worked fairly well. Indeed, modern theories of tort liability suggest that the common carrier should, once again, be strictly liable. See Calabresi, *The Cost of Accidents*, (1970). Carriers may fear excessive liability for fragile objects or unforeseen extraordinary losses. Here, the Board might allow the carriers to specify in large print on the face of the ticket (or otherwise bring to the traveler's direct attention) precisely the fragile objects that are the subjects of limited liability.

first place or, failing that, to ensure against loss, than for customers who are unaware of the complex liability rules to take out private insurance.

Despite the fact that nearly 20 percent of all consumer complaints concern the airlines' treatment of baggage, the Board has been unable to resolve this problem speedily. It has been considering a rulemaking petition of the Aviation Consumer Action Project for more than a year and a half, but no action had been taken at the time of the hearings.[494]

Similarly, the Consumers Union has pointed out that the environment in which the airlines carry dogs, cats, and other pets is highly inadequate. Animals die because of unusual cold, unusual heat, or lack of oxygen. Although the Consumers Union has petitioned the CAB for a change in its rules govening the carriage of live animals, more than a year has passed since the filing of that petition, yet no action has been taken.[495]

Of course, given limited resources, it is impossible to resolve every problem at once. Nonetheless, it is striking to compare the length of time it takes to deal with consumer problems such as overcharges, bumping, lost and damaged baggage, and carriage of animals, with the rapidly efficient enforcement mechanism that immediately begins to fire off telegrams at the slightest suspicion that a passenger who has not been an authentic member of a travel club for the previous 6 months has sneaked on to a charter flight.

5. The failure to investigate fully the possible illegality of certain airlines' political campaign contributions.

On March 21, 1975, the subcommittee held a special hearing to consider evidence that a Board investigation of unlawful airline political campaign contributions had been improperly limited and later halted. The evidence showed the following:

(a) The investigations were begun in the summer of 1973 after it had been publicly revealed in the press that American Airlines had admitted giving unlawful campaign contributions in the presidential campaign of 1972. The purpose of the Board's investigation was to determine whether or not airlines had violated the Board's rules requiring the reporting of all fees, gifts, campaign contributions to to any entity amounting in the aggregate to more than $5,000 in any 1 year.[496] The mere unreported existence of any such contribution would establish a violation of the CAB's rules.

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[494] Hearings at p. 790 (testimony of Patricia Kennedy, tariff analyst, Aviation Consumer Action Project). Two weeks after the subcommittee's hearing, the CAB responded to this petition and an internal study by the CAB staff on baggage handling by promulgating an "Advance Notice of Proposed Rule Making," reprinted in Hearings at p. 1124.

[495] Hearings at p. 830 (testimony of Mark Silbergeld, attorney, Consumers Union).

[496] Schedule G-43 of CAB form 41, 14 CFR pt. 241 (1974), requires filing of the following information:

Schedule G–43—Compensation and expenses of persons and firms (other than directors, officers, and employees) receiving $5,000 or more during the calendar year.

(*a*) This schedule shall be filed by all route air carriers.

(*b*) The indicated data shall be reported for each person or firm, other than directors, officers, and employees of the air carrier, receiving compensation or expense reimbursements of $5,000 or more during the calendar year.

(*c*) Compensation and expenses to be reported in this schedule shall include fees, retainers, gifts, commissions, contributions, allowance for expenses, or any form of payments amounting in the aggregate to $5,000 or more during the year. In addition to expense reimbursements paid directly to the recipients reflected in col. 1, this schedule shall include expenses incurred by the persons or firms named in col. 1 which have been paid directly to vendors by the air carrier. Expenses to be reported in this schedule shall encompass payments such as for legal, medical, engineering, advertising, accounting, statistical, educational or charitable purposes but shall exclude payments for services which both as to their nature and amount may reasonably be regarded as ordinarily connected with the routine physical operation or maintenance of an air carrier such as payments for rent of buildings or property, for heat, light, power, telegraph, and telephone or payments to other carriers for interchange of equipment or settlement of interline traffic balances.

(*d*) "Persons or firms" shall be construed to mean individuals, partnerships, corporations, or other legal entities.

(b) The Board's Bureau of Enforcement proposed an investigation of 34 airlines. It proposed that they be asked a series of questions designed to establish whether (1) the corporation itself had contributed money directly to any political campaign or (2) the corporation had reimbursed campaign contributions made by individual corporate officials. Investigators were to be sent to the field to ask company officials a series of questions. To the surprise of the Bureau of Enforcement staff, the Chairman's office insisted that the questioning of officials of airlines be strictly limited and that no followup questions be asked. Mr. Alterman of the Bureau of Enforcement was instructed by Mr. Hadlock, who in turn was instructed by the Chairman's office, to restrict the investigation to the asking of eight questions of the companies' chief executive officer. Those questions included whether the company itself had made campaign contributions and whether high officials in the company had made personal campaign contributions.

In a number of instances the chief executive officers gave answers that clearly ought to have been followed up. For example, some said that company officials had made personal campaign contributions but then refused to name those officials. Some said that others in the company might know who contributed. (Although personal contributions are lawful, an investigator must establish who gave such contributions as part of an investigation of whether the company reimbursed them.) In one instance, the chief executive officer specifically limited his answer to Federal contributions, though under the Board's rules unreported State contributions would be equally unlawful. In none of these instances were the suspicious answers followed up, for Chairman Timm's office had instructed investigators not to ask follow-up questions.

(c) In November 1973, Acting Chairman O'Melia was head of the Bureau of Enforcement. He had been told in August that he would be appointed a member of the Board and his nomination had been sent to the Senate on September 7. He testified that at the end of the first week of November Mr. Heye, then administrative assistant to the Chairman, came into his office with a note from then Chairman Robert Timm. The note told Mr. O'Melia to close the 34 investigations.

Mr. O'Melia testified that he was shocked by the note and that he sent Mr. Heye back to the Chairman, leaving Mr. Heye with the impression that Mr. O'Melia would do no such thing. Mr. Timm and Mr. Heye denied the existence of any such note or any such instruction.

(d) On November 5, 1973, all 34 of the airline investigations were closed.[497] The relevant papers were collected, put into 34 files, and the 34 files were put in the Bureau's safe. An examination of those files by the subcommittee's staff reveals that the investigations were incomplete. In at least one instance there was an admission by a carrier that it had contributed significant amounts of money to a State political organization. The carrier argued that the organization was not "an entity." The investigatory staff proposed asking the Board's legal division for an opinion on the matter.

The memo containing the request was left in the investigatory file unsent. In other instances there are indications by chief executive officers that members of their company may have made large personal

[497] Prior to the closing of these files, their contents were made available to a representative of the Special Prosecutor's Office, which, however, was charged with the enforcement of a different set of statutes.

contributions, but these statements were not followed up by Bureau of Enforcement officials; no effort was made to find out who these people were and to determine whether their contributions had been reimbursed.

The investigations, which were closed on November 5, 1973, contained signature sheets showing that the investigations required no further action. Those sheets were all signed by two staff members of the Bureau of Enforcement. These two testified that they were not personally familiar with the investigation, but had signed the memorandums at the instruction of Mr. Stout, the Chief of the Investigation and Audit Division. They also testified that such a "closing out" process was entirely contrary to ordinary procedure. Ordinarily, the files would have been sent first to other sections of the Bureau of Enforcement to obtain opinions as to whether or not the investigations should be pursued. Mr. Stout provided the subcommittee with a deposition in which he says he can remember nothing about the closing out of the files.

5. The files remained in the safe until February 1975 when they were found by Mr. Gingery, then head of the Bureau of Enforcement. Mr. Gingery immediately notified the subcommittee staff. In his view, the investigations were incomplete, and the files should not have been closed. Since the discovery of the files, the Bureau of Enforcement has reviewed them and has reopened several of the investigations.

In the subcommittee's view, the record of the hearing on March 21 suggests the possibility of highly improper, unlawful behavior on the part of Board officials. In light of the implication and possible perjury flowing from the fact that directly conflicting statements have been given under oath by the Acting Chairman, and by a former Chairman of the Civil Aeronautics Board, and the possibility of an unlawful obstruction of an administrative proceeding, the subcommittee has referred the record of that hearing to the Department of Justice for further investigation to see whether criminal prosecution is warranted.

6. Conclusions and recommendations.

The subcommittee believes that the evidence presented to it concerning the Board's enforcement activities shows too much emphasis on stopping low-fare flights and too little emphasis on helping the consumer. The subcommittee concludes and recommends the following:

1. The subcommittee's previous recommendations—particularly those urging less restrictive rules governing charter flights, and removal of regulatory barriers to the lowering of fares—taken together should eliminate many of the enforcement problems described to the subcommittee. Since it will be easier to obtain charter flights and to obtain low-cost travel, the rules themselves will be less technical, and passengers will be less tempted to violate them.

2. In any event, the Bureau of Enforcement should reevaluate the manner in which it decides to allocate its enforcement resources. To allocate enforcement resources by responding to complaints is likely to misallocate them, for competitors, complaining about low fares, are more likely to receive attention than consumers, most of whom are reluctant to write complaining about unlawfully high fares. The Bureau of Enforcement should make conscious decisions as to how it will allocate its resources among the variety of problems facing the Board.

3. In order to assure adequate attention to consumer problems, the Office of Consumer Advocate should either be given its own enforcement staff or a significant number of personnel within the Bureau of Enforcement should be given the primary job of enforcing consumer-oriented regulations.

4. The Office of Consumer Advocate should have its budget increased. At present, the Board spends only 13 percent of its total budget on that office—the only component with the primary mission of protecting consumers.

5. The Office of Consumer Affairs and the Board should consider an expanded program of consumer protection including the following:

(a) Strict liability rules governing lost or damaged luggage (with possible exceptions for unusually fragile articles).

(b) "No bumping" rules that allow passengers to agree to run the risk of being "bumped" from an overbooked flight in return for additional compensation if they lose their seat.

(c) Strict requirements in the case of fare reductions that passengers who previously purchased their tickets will be informed at the airport that they may be entitled to refunds.

(d) Spot checks of fare quotations given by major airlines and large fines levied against airlines whose offices are found to overcharge. There is no reason why the supplemental airlines should be held strictly accountable (and forced to pay large fines) for passengers who falsely sign affidavits saying they have been members of clubs for 6 months, unless all airlines, in general, are similarly strictly liable for fare quotations that tend to overcharge customers.

(f) The Office of Consumer Affairs should develop a method by which airline ticket salesmen can speedily inform callers of low-cost promotional (or other low-cost) fares. And the Board, by rule, should insist that information be given to customers. The Office should monitor the training courses provided for sales persons by the companies to make certain that these salespersons are not trained to give out false, misleading, or incomplete information. A pattern or practice of providing false or misleading information should be penalized with significant fines.[498]

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[498] Similarly, the Board might monitor information on flight arrivals and departures, and penalize any pattern of providing false information.

IV. CONCLUSIONS AND RECOMMENDATIONS

A. GENERAL CONCLUSIONS

The subcommittee has examined with care the CAB's administration of classical price, profit, and entry regulation of the airline industry for the past 5 years. It has examined defects in the Board's regulatory system as well as the arguments for and against a more competitive alternative. The subcommittee has reached the following general conclusions:

1. *Air service can be made available to the American public at significantly lower prices.*

Experience in California and Texas, studies by Lockheed and Boeing, and other evidence set out in section II show that it is economically and technically practical to provide fuller-plane, lower-fare service, with fares on many major routes 30–40 percent lower than at present. The public wants such service and should receive it.

2. *Increased competition is likely to bring about the provision of low-fare service.*

Experience in Texas, California, and elsewhere suggests that less strict regulatory control of price and entry allows experimenting with price and service to the ultimate benefit of the air traveler. Though increased competition will change the present pattern of air service, it is more likely to increase, than to reduce, the amount of service provided; and it is unlikely to reduce significantly service to small towns. Other problems foreseen by the industry—such as predatory pricing or destructive competition—should not occur provided that a more competitive environment is brought about carefully and gradually (see sec. II).

3. *The major alternatives to a more competitive policy are unlikely to work effectively.*

Tightening the Board's ratemaking standards to require fuller planes will not cure fundamental defects in the Board's ratemaking system (described in IIIB). It will not allow price experimentation and will produce fares that are too high on long flights. *Discount fares,* while sometimes desirable, are complex, often unfair, and inferior to any system capable of producing *uniformly* lower fares (see pp. 136–41). *Agreements to restrict capacity, limiting flights on certain routes* constitute the least desirable alternative, for they have led to infrequent service without bringing about lower fares. Given the administrative obstacles involved, systems of administered restrictions, limiting the number of flights flown are most unlikely to bring about fare reductions (see pp. 142–153 supra).

4. Board regulation during the past 5 years has not effectively obtained the low fares that consumers desire. Rather, it has primarily sought to protect the regular scheduled airline industry and to promote scheduled service.

Of course, protection of the industry is not necessarily inconsistent with aiding the consumer, but, when the interests of the industry and those of the consumer have diverged, the Board has chosen to protect the industry at the expense of the consumer. When the interests of the large scheduled carriers and those of the smaller scheduled carriers have diverged, the Board has chosen to protect the former at the expense of the latter.

Thus, when faced with the problem of industry overcapacity, resulting from too much investment in aircraft, the Board adopted policies that imposed much of the burden of this faulty investment decision upon consumers, rather than upon the airlines.

In the early 1970's, for example, the Board, without notice or hearing, adopted a "route moratorium" (or route freeze) under which, contrary to the mandate of the Federal Aviation Act, it simply refused to hear applications for route awards. This policy protected existing carriers with routes, but by preventing carriers from obtaining new routes, it inhibited competition to the consumer's detriment. Similarly, the Board, without full hearings, adopted a policy of encouraging and approving agreements among the airlines to restrict scheduled service. The effect of this policy was to reduce service on widely traveled transcontinental routes without any corresponding reduction in price. In neither case was there a showing that these policies, which harmed consumers, were in fact necessary to prevent widespread bankruptcies or diminished air service (see IIIA and IIIC).

The Board's ratesetting policies are similarly aimed primarily at the preservation of the status quo. Although the Board's rate policies are administratively efficient, they severely inhibit any competition or experimentation in price or service that might bring about cheaper or better service by rewarding carriers that are more efficient, productive, or imaginative (see IIIB).

The Board's enforcement policies have been aimed primarily at stopping carriers from offering low-fare service that may violate the complex network of Board rules that severely limit charter travel. By contrast, only a very small proportion of the Board's enforcement resources have been spent to prevent the charging of unlawfully high fares or to deal with other consumer problems (see IIID).

The net result of the Board's practices has not been high profits for the airlines; rather, it has been protection. The Board has tried to protect the scheduled carriers from risk of bankruptcy; it has helped them to pass some, but not all, price increases onto the consumer; and it has helped to protect them from the effects of mistaken investment decisions. Board regulation has, in effect, allowed the carriers to trade freedom for increased security; and it is security, not high profits, that they have received.

At the same time, this security has meant high prices for the consumer. Board regulation has encouraged the carriers to add even more capacity, increasing their costs and adding more service. The result is an elaborate network of scheduled service, with frequent flights and

extra seats, all at high prices. Any reasonable estimate of what consumers want, however, indicates that they would prefer less elaborate service and correspondingly lower fares.

5. The Board's procedures have often failed to meet commonly accepted standards of fairness and openness. In some instances major policies have been determined without a prior opportunity for the public fully to present arguments and alternatives. In other instances, individuals have been injured as a result of Board action that was procedurally unsound.

The major instances in which the Board followed procedures that were improper or of doubtful merit, include the following:

(a) The "route moratorium"—a major Board policy—was instituted without prior hearings as to its merits and was enforced in a manner designed to prevent judicial review (pp. 84–90).

(b) The Chairman's office appears to have interferred with the determination of several particular route cases, improperly ordering (without consultation with other Board members) the postponement of several route cases previously set for hearing (pp. 90–91).

(c) The Board's practice of determining route cases by deciding a motion to "expedite" a hearing wrongly substitutes a procedural decision for what should be a substantive one. It inhibits the development of consistent route award criteria, and it prevents judicial review (pp. 82–83).

(d) The Board's route award procedures, in creating individual standards for decision in each individual case, prevent the development of consistent comprehensible standards that should govern all cases (pp. 83–84).

(e) The Board's procedures leading to the adoption of a minimum charter rate policy allowed no meaningful opportunity for full hearings prior to the adoption of that policy (see Report on Minimum Charter Rates, January 1975).

(f) The Board's procedures for allowing rate changes make it difficult for those opposing fare increases to obtain full hearings (pp. 124–25).

(g) The Board developed its policy of approving carrier agreements to limit capacity—a major Board policy—without full hearings (pp. 154–55).

(h) The Board's charter rules, taken together with the procedures used to enforce them, are unsound in that they impose standards of conduct virtually impossible to meet (pp. 163–65).

(i) The Board prevented Air Europe from offering low-priced service which may have been perfectly lawful by use of press release and private communication, without hearings or a full exploration of the relevant facts and arguments (pp. 165–70).

(j) The Board appears to have improperly suppressed investigations of unlawful political campaign contributions by the airlines (pp. 173–74).

6. The Board's unwillingness or inability to adopt practices that might more successfully protect consumer interests and the related unfairness of some of its procedures have several causes.

It is often argued that agency tendencies to look after industry, rather than consumer, interests are a result of regulators having too much private contact with, and becoming too dependent upon, in-

dustry representatives. Those wishing to make that argument here can produce a strong case. Certainly the 769 private meetings held between Board members and industry representatives in 1974 must have had some effect in helping the Board understand industry's point of view. Industry representatives are well-informed, they intensely urge that the Board pay attention to the industry's problems, and they can make the Board and its staff aware of their responsibility for the industry's health. Indeed, the decisions to adopt a "route moratorium," to approve capacity restricting agreements, and to encourage minimum charter rates were preceded by private meetings with industry officials at which the industry's financial problems were discussed. And the industry is a possible source of jobs for the future: about one-half of all Board members obtained such a job upon leaving the Board.

On the other hand there is no evidence that any of the private meetings involved matters that are considered improper under the Board's *ex parte* rules. Nor is it desirable or necessary to end all informal contact between Board members and industry representatives (see pp. 93–94). In fact, to see the Board's problems as entirely cured by "industry contact" is overly simplistic, for other important institutional factors were also at work.

For one thing, the defects noted in the Board's procedures, practices, and actions arise almost inevitably out of its efforts to apply classical price, profit, and entry regulation to an industry where it does not belong. Due to its highly competitive and cyclical nature the industry's environment is everchanging. How then can the Board develop uniform procedures and policies that will set proper rates? The Board, if determined to engage in classical regulation, has three basic choices:

(1) It might use formal hearings to resolve every major policy problem. To do so, however, consumes vast amounts of time, energy, and resources. The DPFI, for example, the second major fare investigation in the Board's history, took 5 years to complete. The hearings in the "capacity restricting agreements" case, once begun, took 16 months to reach a preliminary decision.

(2) The Board is therefore tempted to substitute reliance upon negotiation for reliance upon the "due process" hearing. By staying in close contact with industry members, the Board's staff can learn about industry problems, it can find out industry predictions of costs and revenues, and it can more easily formulate appropriate policies. It can informally force acceptance of these policies. Just this type of "negotiating" characterized major ratemaking decisions prior to the *Moss* case. Just this form of procedure—carried out tacitly, at a distance, through meetings, speeches, hints, internal discussions and suggestions—was responsible for the "route moratorium."

The virtue of this procedure is administrative efficiency and an organization that understands the problems of the industry. Its vice, quite obviously, is that it is unfair. Consumers are unrepresented and their viewpoint is often unheeded. Moreover, there is no easy way, in an informal negotiation, to test out the sometimes unreliable facts, figures, and arguments that the industry proposes.[499]

[499] Cf. discussion of the ATA study, supra at pp. 66–68.

(3) The Board's only other major alternative is to try to substitute complex rules and regulations that *automatically* adjust, without elaborate hearings, to industry conditions as they change. Just this type of ratemaking procedure was elaborated in the Board's DPFI. But, as analysis shows, this automatic ratemaking procedure—while administratively simple and desirable—produces results that are highly detrimental to consumers.

If the drawing up of complex, automatic regulatory rules is virtually impossible, and if the setting of every major case for hearing is unworkable, the Board is understandably tempted to solve most problems through informal meetings and negotiations. This tendency, in turn, may produce an environment in which the Board's failure to hold a hearing, even concerning such major changes of policy as a route moratorium or the introduction of capacity-restricting agreements, has become commonplace. This same environment effectively keeps a low-cost carrier such as Air Europe from flying and is imposed without any thought that some opportunity to hear both sides of the argument might be desirable.

For another thing, the institutional history of the Civil Aeronautics Board and the statute push the agency in the direction of industry protection. The Board was created in the thirties during the depression, when competition was looked upon with suspicion and disfavor. Further, the airlines, at that time, were on subsidy. A subsidized airline is tempted to price its services below cost in order to expand its route structure and company size, making up the difference, if possible, from the Government's subsidy. The Government's primary interest when the Board was created was the expansion of the industry. Thus, born in an environment distrustful of competition, faced with the problem of airlines tempted to price below cost, and seeing its primary mission as one of industry expansion, the Board's response—one of industry promotion and protection—is hardly surprising. Moreover, during the fifties the Board was under strong political pressure to terminate the airline's subsidy. The need to protect airlines from bankruptcy was thus reinforced.

Finally, the statute itself is ambivalent. It aims both at industry promotion and protection, and also at competition, consumer protection, and low fares. The ambivalence and vagueness of the statute gave the Board ample room to pursue the first of these goals at the expense of the second.

Whatever the needs of the forties and fifties, however, the seventies require a shift in direction toward the second of the statute's major goals. Having overseen the development of a widespread network scheduled service, it ought now to be the Board's primary mission to see that that service is made available to passengers at a price that all can afford.

The seventies will require not expansion of service, but efficiency in providing existing service; not a high fare policy designed to protect all firms from bankruptcy, but a low fare policy designed to make airline service available to all Americans. It will be difficult to shift the Board's aim from the first of these goals to the second, however, for, in doing so, it will be necessary to fight nearly 40 years of institutional tradition, rule, and behavior.

7. To provide the consumers with the adequate, low-fare service that is technically and economically possible, and to promote greater efficiency in the provision of that service, a radical change in the Board's order of priorities and the procedures used by the Board in the carrying out of its statutory mandate, will be necessary. The Board should shift from reliance upon the procedures of classical price and profit ratemaking toward greater reliance upon competitive forces in an effort to guarantee the widespread provision of low cost, efficient service.

Despite the drawbacks of reliance upon competition—the greater uncertainty and the increased risk for individual carriers—competition does provide a practical, workable alternative to the present reliance upon classical ratemaking procedures. The Board's present procedures are inadequate, and there is little indication that more formal procedures would work a major change in results. Given the imperfections inherent in the classical ratemaking process, particularly when used to control a highly competitive industry operating in a volatile economic environment, it is preferable to rely increasingly upon competition as a substitute for the complex set of regulatory rules which the Board now operates.

8. Any major change in Board policy toward increased reliance upon competition must take place gradually.

"Economic policy," wrote Maynard Keynes, "should not be a matter of tearing up by the roots but of slowly training a plant to grow in a different direction." The industry has grown up under a system of classical regulation. Its managers must have time to learn how to plan and to act under an increasingly more competitive environment.

B. RECOMMENDATIONS

The subcommittee's recommendations are aimed at eliminating the unfairnesses found in current Board procedures, substituting, gradually, over time, increased reliance upon the competitive process for determining appropriate fare levels, and increasing the attention paid by the Board to a variety of consumer problems. These recommendations, here, which repeat those made through the body of the report, include the following:

1. Route awards.

a. Procedural Recommendations

(1) The procedures used by the Board to formulate and to administer its "route moratorium" should be abandoned. Major shifts in Board policy should not be determined, or announced, through informal meetings, speeches to the industry, private staff discussions, and decisions in particular, individual cases—without providing an opportunity for members of the industry and of the general public affected by such a policy to submit their views to the Board prior to the policy's formulation. In other words, the Board should actively seek statements of position, proofs, and arguments related to proposed changes in general policy before the Board makes up its mind. Such statements should be open to the public so that each party can comment upon the statements of others.

(2) The Board, in route cases, should abandon the use of a procedural motion—the motion for an expedited hearing—to set substantive policy. It should, instead, develop a summary judgment procedure under which it either dismisses a case outright as unwarranted or proceeds, in the ordinary course of affairs, to hold a hearing on the application. Priority among applications which survive a "summary judgment" procedure should not be determined on the basis of an estimate of the "relative strength" of the application. Rather, the Board should develop neutral criteria such as "first come first served" perhaps tempered by numerical estimates of the size of the potential market and the number of carriers currently serving it (giving priority consideration to monopoly or underserved markets).

(3) The Board should revise its standards governing ex parte communications. At present the Board's rules forbid ex parte communications only concerning matters that are already the subject of agency adjudicatory proceedings.[500] Yet, as the subcommittee found in its hearing on minimum charter rates last November and documented in its report on those hearings, policy positions are formulated by the Board prior to the Board's announcement that it intends to hold rulemaking or adjudicatory hearings. This fact, taken together with the large number of private meetings between industry members and the Board, has severely shaken public confidence in the impartiality and fairness of the agency's actions.

Any change in ex parte communications standards should take place in two directions. First, the definition of ex parte communications should be tightened so that it includes not simply the matters that are currently the subject of agency proceedings, but, also matters which the Commission believes are likely to become the subject of such proceedings within the subsequent 6 months to a year. Second, at the same time the ex parte communications rules should be liberalized so that they do not forbid all such communications. Rather, the rules governing the communications should be tailored to the type of communication at issue. Thus, for example, all communication related to an actual adjudicatory proceeding should be forbidden. Communications related to a possible rulemaking proceeding, however, need not be forbidden; rather, they might be transcribed and made available to the public. Or, each Board member might be given the full power under general standards to distinguish between significant and insignificant communications, fully transcribing the former, while simply noting, in summary, that the latter have occurred. Finally, all private meetings with industry members or other private parties might simply be noted in a log, which is publicly filed.

The exact details of changed rules must be worked out by the agency in light of its particular problems. Yet, the subcommittee feels that the substitution of this type of "spectrum" approach to the problem of ex parte communications is preferable to the present system which absolutely forbidding one significant subset of all private communications but does not control others at all.

(4) The Board should develop a strict set of time limits applicable to route applications. The fact that route applications in Texas can be processed within a 3-month period while similar applications pending before the Board take several years suggests that the Board both can and should speed its route award proceedings. The subcommittee urges the Board to develop and promulgate a set of standards designed to do just that.

[500] See 14 CFR sec. 300.2(a) (1974).

b. Substantive Changes

While the subcommittee endorses an open-entry policy as a future goal, it believes that the Board and Congress must proceed in a more competitive direction, cautiously, in a series of measured steps. The subcommittee recommends the following changes:

(1) The Board should reject the route award standards proposed in the BOR study discussed in note 250, supra.

(2) The Board should ratify the testimony of Acting Chairman O'Melia by formally announcing that the route moratorium is at an end and that hearings will be provided for all those carriers proposing full-plane low-fare service.[501]

(3) The Board should develop a cautious, measured program that gradually liberalizes entry into the industry, with the object of promoting rate competition. Such a program might consist of one or more of the following elements:

(a) The Board would immediately begin to weigh a carrier's offer to lower rates as a very important factor in favor of granting a route application.

(b) The Board would immediately begin to allow existing carriers to remove route restrictions. To eliminate waste, carriers—including international carriers—would be granted "fill-up" rights on route segments that they already fly. As a step toward liberalizing entry, for example, carriers might also be allowed to fly nonstop over segments that they now fly one-stop.

The procedure used as part of a liberalized route award policy is of great importance. The subcommittee suggests the use of strict time limits and a shifting of the burden of proof on to those who would oppose the awarding of an application. For example, a carrier wishing to remove a restriction would have to show that it is "fit, willing and able" to fly the unrestricted route. The Board would be required to make this determination within 6 months [502] of the application. Moreover, prior to the end of 6 months, the Board would be allowed to deny a request to remove a restriction only upon a determination that its removal would "seriously impair the frequency of air service on the affected route." After 6 months, if the Board had not concluded the proceeding, it would be required to award the carrier a "provisional" certificate without the restriction; that certificate would automatically become permanent within 9 additional months unless the Board found "by clear and convincing evidence" that the award "had severely impaired the frequency of service on the affected route."

(c) The Board would immediately liberalize its charter rules as suggested at pp. 133–34, infra.

(d) If the first three steps (a–c above) worked reasonably well, the Board might, after an appropriate period, proceed further by allowing existing certificated carriers to fly any route segments that connect with their present route segments, upon a showing that they are "fit, willing and able" to provide such service. The procedure followed would be that outlined in "b" above.

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[501] See Hearings at p. 649.

[502] Time limits could be extended only if the Board finds that the applying carrier has been deliberately dilatory.

(e) The Board might, further, after a period of time allow any supplemental carrier to offer scheduled service on any such route upon a showing that it was "fit, willing and able" to provide service. Again, the procedure followed would be that outlined in "b" above.

(f) If the above five steps worked reasonably well, the Board could, after a reasonable time, allow any firm wishing to supply air service on any route to do so, provided that it demonstrated that it is "fit, willing and able" to do so. The procedure followed would be that outlined in "b" above.

(g) As such a program is implemented, the Board would correspondingly allow carriers to discontinue unprofitable service provided that adequate substitute service by commuter carriers or others is made available.

These recommendations are meant to suggest a possible step-by-step program moving towards open entry. The Board could pull back from such a program if, after a reasonable period of time, it determined that the quality of air service was seriously threatened. Similarly, if Congress mandates such a program legislatively, it could retain the option of slowing down or terminating the experiment should serious threats to the quality of air service appear.

2. Ratemaking procedures.

The subcommittee's major recommendations concerning rate policy include the following:

(a) The Board should allow carriers flexibility to set the prices they desire. It should retain a price ceiling, but remove any price floor. A lower bound on prices would be determined by the antitrust laws' prohibition against predatory pricing. Exceptions to the price ceiling should be made only in unusual cases, upon a demonstration that service on a particular route would be canceled or severely limited in the absence of a price increase. When route awards are liberalized to the point where the threat of entry will hold down prices, the price ceiling can be removed.

(b) Restrictions on charter travel should be significantly liberalized along the lines provided by S. 421.

(c) Price discounts that reflect cost savings should be automatically allowed.

(d) The carriers should be allowed wide latitude to introduce discounts that embody pure price discrimination. If the Board adopts the first recommendation ("a" above), it will be difficult as a practical matter for carriers to maintain systems of price discrimination. Otherwise, the Board should evaluate price discriminatory proposals in accordance with the rough ranking set out at pp. 140–41, supra. The Board might use this rank order and proceeding analysis in exercising its power to set aside prices on the grounds that they are unreasonably discriminatory.

3. Antitrust immunity.

a. The Basic Standard

The subcommittee recommends that the Board, in passing on requests for antitrust immunity, used the standard currently working with success in the field of bank regulation. Such a standard, modeled

after the Bank Merger Act, would make any agreement that would violate the antitrust laws unlawful unless "the anticompetitive effects are clearly outweighed in the public interest by the need to secure a significant transportation objective." The Board has adequate power to apply this standard presently. Indeed, the standard seems very similar to the standards announced in the Board's *Cartage* case.

If legislation is enacted, the subcommittee recommends limiting antitrust attacks on approved agreements to the Antitrust Division of the Justice Department, setting a strict time limit within which the Division must decide whether to attack an approved agreement but allowing the courts to review the legality of the agreement *de novo*, applying the above mentioned standard. Such court review would require a change in a current law. Even without such a change the Board could implement the above standard in its own proceedings while according due deference to the opinions of the Department of Justice and Transportation in their areas of relative expertise.

b. Liason

The subcommittee recommends that the Board established liaison procedures with both the Department of Justice and the Department of Transportation for use in developing staff positions and for reaching final decisions in cases involving requests for antitrust immunity. Informal liaison procedures will enable the Board's staff to have the benefit of the expert advice of both the Justice Department and the Transportation Department in these matters before the Board's staff takes a position in Board proceedings. In the proceedings themselves, both the Department of Justice and the Department of Transportation should be allowed to intervene. Moreover, in reaching a decision, the Board should give considerable weight to the expert view of the Department of Justice insofar as that view concerns likely anticompetitive or procompetitive consequences of the proposed agreement. The Board should give equal weight to the expert opinion of the Department of Transportation in determining whether or not there is a significant transportation need that an anticompetitive action is necessary to satisfy.

c. Hearings

The subcommittee recommends that the Board develop standards for determining when hearings are to be granted on request for antitrust immunity. Obviously, given the fact that there are nearly 1,000 requests for approval under section 412 may be filed in a year, and the fact that most of these are not controversial, it would be impractical and unnecessary to hold hearings in each case. Yet only about 9 percent of these involve possible anticompetitive consequences. And, of those, presumably a still smaller number are controversial. As to these, the Board should ordinarily grant hearings prior to approving agreement. The Board's standards should clearly state that requests for hearings in such cases by the Department of Justice or the Department of Transportation will, as a matter of course, be granted. And, the Board's rules should provide that departures from the "prior hearing" procedure will be infrequent.

4. Enforcement.

The subcommittee believes that the evidence presented to it concerning the Board's enforcement activities shows too much emphasis on stopping low-fare flights and too little emphasis on helping the consumer.

a. The subcommittee's previous recommendations—particularly those concerning less restrictive rules governing charter flights and removal of regulatory barriers to the lowering of fares—should, taken together, eliminate many of the enforcement problems described to the subcommittee. Since it will be easier to obtain charter flights and to obtain low-cost travel, the rules themselves will be less technical, and passengers will be less tempted to violate them.

b. In addition, the subcommittee recommends: The Bureau of Enforcement should reevaluate the manner in which it decides to allocate its enforcement resources. To allocate enforcement resources by responding to complaints is likely to misallocate them, for competitors, complaining about low fares, are more likely to receive attention than consumers, most of whom are reluctant to write complaining about unlawfully high fares. The Bureau of Enforcement should make conscious decisions as to how it will allocate its resources among the variety of problems facing the Board.

c. In order to assure adequate attention to consumer problems, the Office of Consumer Advocate should either be given its own enforcement staff or a significant number of personnel—within the Bureau of Enforcement—should be given the primary job of enforcing consumer-oriented regulations.

d. The Office of Consumer Advocate should have its budget increased and should be authorized to award attorneys' fees to public interest interveners in Board proceedings under standards set by the Board.

e. The Office of Consumer Advocate, and the Board, should consider an expanded program of consumer protection including the following:

(1) Strict liability rules governing lost or damaged luggage (with possible exceptions for unusually fragile articles).

(2) "No bumping" rules that allow passengers to agree to run the risk of being "bumped" from an overbooked flight in return for additional compensation if they lose their seat.

(3) Strict requirements in the case of fare reductions that passengers who previously purchased their tickets will be informed at the airport that they may be entitled to refunds.

(4) Spot checks should be made by Board staff of fare quotations given by major airlines, and large fines should be levied against airlines whose offices are found to overcharge. There is no reason why the supplemental airlines should be held strictly accountable—and forced to pay large fines—for passengers who falsely sign affidavits saying they have been members of clubs for 6 months, unless all airlines, in general, are similarly strictly liable for fare quotations that tend to overcharge customers.

(5) The Office of Consumer Advocate should develop a method by which airline ticket salesmen can speedily inform callers of low-cost promotional, or other low-cost, fares. And, the Board, by rule, should

insist that information be given to customers. The Office should monitor the training courses provided for sales persons by the companies to make certain that these sales persons are not trained to give out false, or misleading, or incomplete information. A pattern or practice of providing false or misleading information should be penalized with significant fines.[508]

C. LEGISLATION

Given the uncertainty as to whether the Board will adopt the subcommittee's recommendations, the subcommittee believes that legislation is desirable. There is presented here one list of specific statutory amendments that is meant not as a definitive legislative proposal but as an illustration of the type of legislative change that is felt necessary.

1. Amendments to the Federal Aviation Act.

a. Section 102, setting forth basic regulatory goals, should be amended along the following lines to encourage the promotion of price competition:[508a]

> Section 102, 49 U.S.C. 1302
> Declaration of Policy: The Board
> Sec. 102. In the exercise and performance of its powers and duties under the Act, the Board shall consider the following, among other things, as being in the public interest, and in accordance with the public convenience and necessity:
> (a) The encouragement and development of an air-transportation system *responsive to the public need for adequate, efficient, low-cost service and* properly adapted to the present and future needs of the foreign and domestic commerce of the United States, of the Postal Service, and of the national defense;
> (b) The regulation of air transportation in such manner as to recognize and preserve the inherent advantages of, assure the highest degree of safety in *provide reasonable wages, costs, working conditions, and profits in* and foster [sound economic conditions in,] *reliable public service from* such transportation [, and to improve the relations between,] and coordinate transportation by [,] air carriers;
> (c) The promotion of adequate, economical, and efficient service by air carriers at reasonable charges, without unjust discriminations, undue preferences of advantages, or [unfair or] destructive competitive practices;
> (d) [Competition to the extent necessary to] *The provision of competition between and among air carriers, including the establishment of qualified new air carriers, in order to* assure the sound development of an air transportation system [properly adapted to] *that meets* the needs of the foreign and domestic commerce of the United States, of the Postal Service, and of the national [defense;] *defense; and*
> (e) The promotion of safety in air commerce; and the promotion, encouragement, and development of civil aeronautics.

b. Section 401(d)(1) and section 401(e) of the act should be amended to provide an orderly transition to a more open entry policy:

> (d)(1) The Board shall issue a certificate authorizing the whole or any part of the transportation covered by the application, if it finds that the applicant is fit, willing, and able to perform such transportation properly, and to conform to the provisions of this Act and the rules, regulations and requirements of the Board hereunder, [and that such transportation is required by the public convenience and necessity; otherwise such application shall be denied] *unless the Board determines by clear and convincing evidence that to issue such certificate will severely impair the frequency of service on the affected route.*

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[508] Similarly, the Board might monitor information on flight arrivals and departures and penalize any pattern of providing false information.

[508a] Material added to current statute is italicized, while material deleted from current statute is bracketed.

(c) Upon the filing of any such application, the Board shall give due notice thereof to the public by posting a notice of such application in the office of the Secretary of the Board and to such other persons as the Board may by regulation determine. Any interested person may file with the Board a protest or memorandum of opposition to or in support of a certificate. Such application shall be set for a public hearing and the Board shall dispose of such application *within six months, unless the applicant or those supporting the applicant have been dilatory.* [as speedily as possible]. *If the proceeding has not been completed within six months, unless the Board then determines that the applicant is not fit, willing, or able to provide service, the Board shall issue the applicant a provisional certificate which shall become final within nine months after the applicant commences service unless the Board finds by clear and convincing evidence that the award of the certificate has severely impaired the frequency of service on the affected route.*

The proposed amendments illustrated above probably should not take effect immediately; rather, a reasonable amount of time should elapse to allow existing airline firms, airline creditors and other interested parties to plan rationally for the freer-entry environment. During the transition period, however, and shortly after the enactment of the amendments, the Board itself should be required to formulate and transmit to the Congress a plan of transition toward a more open-entry policy. Unless the Congress rejects the Board's plan through perhaps a concurrent resolution of both Houses, the Board should be allowed to promulgate that plan provisionally whether or not full hearings have been completed. In any event, based on consultation with interested parties and the evidence presented throughout the hearings, the subcommittee tends to believe that the open-entry amendments should become fully operative in no less than 2 but no more than 6 years from the date of enactment.

c. Section 1002(d) should be amended to prevent the Board from setting minimum rates. (Predatory pricing can be controlled through the power of the Department of Justice to enforce the antitrust laws.)

Section 1002(d), 49 U.S.C. 1482(d): Power To Prescribe Rates and Practices of Air Carriers.

(d) Whenever, after notice and hearing, upon complaint, or upon its own initiative, the Board shall be of the opinion that any individual or joint rate, fare, or charge demanded, charged, collected, or received by any carrier for interstate or overseas air transportation, or any classification, rule, regulation, or practice affecting such rate, fare, or charge, or the value of the service thereunder, is or will be unjust or unreasonable, or unjustly discriminatory, or unduly preferential, or unduly prejudicial, the Board shall determine and prescribe the *maximum* lawful rate, fare, or charge [(or the maximum or minimum, or the maximum and minimum thereof)] thereafter to be demanded, charged, collected, or received, or the lawful classification, rule, regulation, or practice thereafter to be made effective:

Provided, that as to rates, fares, and charges for overseas air transportation, the Board shall determine and prescribe only a just and reasonable maximum [or minimum, or maximum and minimum] rate, fare, or charge.

(d). To limit the power of the Board to grant antitrust immunity, section 414 of the act shall be amended by adding at the end of the present section the following words: "No antitrust immunity will be granted by the terms of this act unless the Board specificially determines that any anticompetitive effects of the agreement that is the subject of the Board's order are clearly outweighed in the public interest by the need to secure a vital transportation objective. Despite any such Board finding, the Antitrust Division shall retain the right to bring an antitrust action attacking any such agreements, in an

appropriate court of law within 90 days of the granting of the Board's approval. In any such action the court shall, after de novo review, apply the antitrust laws as modified by the above standard to determine the legality of the approved agreement."

2. Procedural legislation.

If the Federal Aviation Act is not amended, the subcommittee believes that many of its recommendations can be brought into effect by reallocating the procedural burdens of proof among the Department of Justice, the Department of Transportation, and the Board. Legislation along the following lines is recommended:

3. Regulatory and competitive conflicts.

a. A regulatory and competitive conflict exists when an agency that regulates prices, profits, or entry in a structurally competitive industry takes action or maintains any practice that may lessen competition within that industry substantially, when it allows, approves, sanctions, licenses, requires, or encourages any such action or practice on the part of a firm or firms within that industry, or when a firm or firms within that industry take any such action or engage in any such practice.

b. No agency shall maintain or allow any act or practice, whether of the industry or that agency, that is the subject of a regulatory and competitive conflict, unless it finds that the anticompetitive effects of any such action or practice are clearly outweighted in the public interest by the need to secure a vital regulatory objective.

c. If the Attorney General requests a hearing to determine whether a designated act or practice, of the regulatory agency or the regulated firms, creates a regulatory/competitive conflict, the regulatory agency must hold a full and speedy hearing in accordance with the provisions of the Administrative Procedure Act, and determine the lawfulness of the act or practice in accordance with the standard set out in section b above. In applying such standards the agency will give appropriate weight to the expert opinion of the Department of Justice in determining the probable effects of an act or practice upon competition. Any agency that regulates transportation shall also give appropriate weight to expert opinion of the Department of Transportation in determining the need for any act or practice to secure a vital regulatory objective.

Appendix A

List of Witnesses

Aaronson, Robert J., administrator, State Aviation Administration, *Maryland Department of Transportation*
Alterman, Stephen A., former Assistant Chief, Formal Proceedings Division, Bureau of Enforcement, CAB
Baker, Donald I., Deputy Assistant Attorney General, Antitrust Division, *Department of Justice*
Barnum, John W., Acting Secretary, *Department of Transportation*
Beamish, Edward A., senior vice president, corporate planning, *United Air Lines*
Beckman, Robert, attorney, *Air Europe International*
Burns, Bernard B., former investigator, Bureau of Enforcement, CAB
Clifford, Robert W., president, *Air California*
Colodny, Edwin I., executive vice president, marketing and legal affairs, *Allegheny Airlines*
De Voursney, Andrew M., group vice president, finance and planning, *United Air Lines*
Dingivan, Edward A., vice president, *National Air Carrier Association*
Eads, George C., assistant director, *Council on Wage and Price Stability*
Edison, Peter C., former Assistant Chief, Informal Compliance Division, Bureau of Enforcement, CAB
Ehrlich, Morton, vice president for planning and chief economist, *Eastern Airlines*
Engman, Lewis, Chairman, *Federal Trade Commission*
Finney, Thomas D., counsel, *Continental Air Lines*
Gagnon, James, Chairman, ad hoc committee on air service, *Airport Operator Council International*
Gillilland, Whitney, Vice Chairman, *CAB*
Gilstrap, Roderick W., first vice president, *Air Line Pilots Association*
Guske, Lawrence A., assistant controller, *Pacific Southwest Airlines*
Hadlock, Gerald F., former Deputy Director, Bureau of Enforcement, CAB
Hardensteine, William A., senior vice president of sales, *World Airways*
Heye, Thomas, former Administrative Assistant to Robert Timm, Chairman, CAB
Hinckley, G. F. Steedman, chairman and chief executive officer, *Overseas National Airways*
James, George W., senior vice president of economics and finance, *Air Transport Association of America*
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Murphy, Charles, executive director, *Texas Aeronautics Commission*
Muse, Lamar M., president, *Southwest Airlines*
Nader, Ralph
Noll, Roger G., professor of economics, California Institute of Technology
O'Melia, Richard J., Acting Chairman, *Civil Aeronautics Board*
Peck, Merton J., professor of economics, Yale University
Rasenberger, Raymond J., counsel, *North Central Airlines*
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Rodriguez, Elias, C., former Chief, Informal Compliance Division, Bureau of Enforcement, CAB
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Silbergeld, Mark, attorney, *Consumers Union*
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Timm, Robert D., former Chairman, presently Member, *CAB*
Tipton, Stuart G., senior vice president, Federal affairs, *Pan American World Airways*
Wegscheider, Jens Jurgen, Travel Information Bureau
Weldon, James L., Deputy Director, Bureau of Enforcement, CAB
West, Lee R., Member, *CAB*
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Persons Who Submitted Additional Material at the Subcommittee's Request [1]

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Bower, Richard S., professor of business economics, Dartmouth College (consultant to the subcommittee)
Brenner, Melvin A., vice president, marketing and planning, Trans World Airlines
Douglas, George W., professor of economics, University of Texas
Drake, John W., professor of air transportation, School of Aeronautics and Astronautics, Purdue University
General Accounting Office
Glass, Stuart, legislative attorney, Congressional Research Service, Library of Congress
Keeler, Theodore E., assistant professor of economics, University of Chicago (consultant to the subcommittee)
Keyes, Lucille, independent economist (consultant to the subcommittee)
Kimbriel, Harry A., Jr., vice president, Alliance One
Moser, Herbert H., vice president, Merrill Lynch, Pierce, Fenner & Smith
Paul, Grayden, M., director, airline requirements, Lockheed-California Co.
Peltzman, Sam, professor of economics, University of Chicago (consultant to the subcommittee)
Sherman, Roger, professor of economics, University of Virginia
Whinston, Andrew, professor of economics, management and computer science, Purdue University

[1] Persons, other than witnesses listed above, who prepared special studies at the request of the subcommittee. In addition, all CAB-regulated airlines and the major intrastate airlines answered extensive questionnaires from the subcommittee. The subcommittee was also given valuable assistance and advice from Michael E. Levine, Luce professor of law, California Institute of Technology, and Christopher Barnekov, assistant professor of economics, Ohio State University, and Geoffrey White.

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Appendix B

A Short History of Federal Economic Regulation of the Domestic Scheduled Passenger Air Transport Industry, 1925–74

This appendix reviews the early history of civil aviation in the United States, the legislative history of the Civil Aeronautics Act of 1938, and the history of regulation by the CAB for the purpose of reviewing certain fundamental historical issues which were raised, either explicitly or implicitly, by the oversight hearings of the subcommittee. Our primary focus will be upon the following areas: the growth of the Big Four—American, Eastern, TWA, and United—prior to 1938, the Congressional choice of "regulated competition" in 1938 and the degree to which Congress intended to restrain healthy competition by means of regulation; and the extent to which the CAB may have departed fundamentally from the original Congressional intent and Congress may have acquiesced in these practices.

No attempt is made to evaluate the various economic and political arguments that have been used to buttress the diverse positions of the past. Nor is a complete review of CAB's activities intended. The goal of this section of the subcommittee's report is only to present the story of the origins and funtioning CAB regulation and Congressional response in sufficient detail to enable our colleagues form their own opinions upon the historical conclusions that we offer and to help them consider our detailed investigation of recent CAB activities with the aid of historical perspective.

I. FEDERAL REGULATION PRIOR TO 1938 AND THE EVOLUTION OF THE CIVIL AERONAUTICS ACT

EARLY CONGRESSIONAL REGULATION OF AIRMAIL CONTRACTS 1925–30

The history of civil aviation began in the United States in practical terms on February 2, 1925, when Congress passed the Kelly Act,[1] which permitted the Postmaster General to award contracts to private airlines for the carriage of the U.S. mail.

Prior to 1925, all airmail had been carried by the army.[2]

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[1] Act of February 2, 1925, ch. 128, Stat. 43.

[2] The first unmanned heavier-than-air flight in the world was achieved on May 6, 1896 by Samuel P. Langley, secretary of the Smithsonian Institute. In 1898, during the Spanish-American War, President McKinley granted Langley $50,000 to build a man-carrying war aircraft. The first manned flight was achieved not by Langley, but by Wilbur and Orville Wright at Kitty Hawk, N.C., on December 17, 1903.

The possibilities of manned flight were generally ignored for 5 years until 1908 when the Army accepted a Wright brothers bid to build a 2-person airplane. The United States was really not shaken from its indifference toward the airplane until 1917. Although the Europeans had quickly developed aviation through a series of meets and contests, the United States found itself on the eve of entrance into World War I less prepared than Europe was in 1914. The Army air corps consisted of 55 obsolete airplanes. The Congressional response was to appropriate $640 million for an air program, the largest single appropriation to date. Within 3 months, 3,431 combat planes were built. By the close of war in October 1918, the United States was producing aircraft at the rate of 18,000 per year. See, generally, N. H. Randers-Pehrson, *History of Aviation* (1944).

At the end of the First World War, the Federal Government decided to explore the potential for using the airplane to deliver mail. In 1918 largely supplied with Army planes, men, and expertise the Aerial Mail Service was organized within the Post Office. The first airmail service was instituted from Washington, D.C. to Philadelphia to New York on August 12, 1918.[3]

Both because the Federal Government was the only buyer of airmail transport and because early aviation required a large and sustained flow of public development funds, the Federal Government necessarily "regulated" the privately owned civil aviation, which developed in response to the Kelly Act of 1925, in the sense that Government decided how much it was willing to pay for mail contracts, who would hold these contracts, and along which routes the mail should be carried by air. Air transportation of *passengers* remained unprofitable until about 1938, the year in which the Civil Aeronautics Board was established.[4]

The key provision of the Kelly Act was that the contract payment to the airlines must be "at such rate not to exceed ¾ of the revenues derived from such air mail." This provision tied the rate of compensation of the airlines to the postage rate, which was statutorily set at a minimum of 10¢. Since the postage rate also determined the amount of mail that the public would send at that rate, tying the carriers' compensation to the postage rate prohibited carriers from adjusting contract rates to their flying costs, which varied more with number and length of flights rather than the number of pieces of mail carried. Futhermore, the Kelly Act required a wasteful double counting of the mail—once by the Post Office and once by the carrier—and established an irrational apportionment of costs.

Although not required by the statute, the Postmaster General proceeded to award contracts by competitive bids. The shorter airmail routes were first put up for bids to permit private carriers to gain experience before taking over the transcontinental routes. On September 15, 1925, 10 companies submitted 19 bids for 8 routes. The bidding was restricted to companies with proper equipment and experience. Three companies were eliminated for lack of proof of financial backing. As a result, only five routes were awarded. All of the five successful companies were forerunners of today's Big Three—American, TransWorld, and United Air Lines.

The fledgling airlines were reluctant to bid on the long routes because of the need to spend large sums for navigational and airport equipment which could then be used by other companies. Congress therefore passed the Air Commerce Act of 1926 by which the public assumed the cost of navigation and airports and, at the same time, the Government began to regulate the safety of airlines.[6] Provisions were made for registration of aircraft certificates of air-

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[3] Robert M. Kane and Allan D. Vose, *Air Transportation* 22 (4th ed. 1974). Except for occassional stunts and exhibitions, the airmail was the first civilian use of the airplane. This was the logical first step. In the early stages of aircraft technology airplanes were severely limited in the amount of weight and volume they could transport. The only commercially reasonable use of the early aircraft was for the transportation of small lightweight articles for which speedy delivery was economically valuable.

[4] The CAB was originally called the Civil Aeronautics Authority until 1940. Since the essential functions and authority of the Board have not changed, for the sake of simplicity, this report will consistently refer to the CAB and its predecessor Civil Aeronautics Authority as the "Civil Aeronautics Board" or "CAB."

[5] See Henry Ladd Smith, *Airways*, 2d ed. 6 (1965).

[6] Air Commerce Act of 1926, ch. 344, 44 Stat. 2.

worthiness, and examination and rating of airmen. These certificates were awarded under standards determined by the Secretary of Commerce and could be revoked by him. Furthermore, the Secretary was authorized to establish air traffic rules and designate civil airways. Congress specifically forbid the Secretary from granting an exclusive right of way to an airline.

In the same year Congress also adopted the 1926 Amendment to the Kelly Act [7] which modified the unworkable fraction-of-postage system of setting contract rates established by the Kelly Act. A proposal to give the Postmaster General unfettered discretion to set rates was rejected as too dangerous.[8] Instead Congress provided for a pound system of compensation under which contract rates were to be no more than $3.00 per pound for the first 1,000 miles and $0.30 per pound for each additional 100 miles or fraction thereof. The major significance for this change was that the postage rate and hence the amount of airmail was separated from the carrier compensation rate and thus the total revenue of the carriers. This separation permitted payments to the carriers to exceed the value of the service they provided, i.e., permitted the Post Office to directly subsidize the airlines.[9]

Nevertheless, the failure of Congress to recognize the difference between the cost of flying 300 miles as opposed to 1,000 miles perpetuated carrier reluctance to enter the long-haul markets.

On February 1, 1927, the Postmaster General significantly reduced the postage rate. This reduction, plus the transatlantic flight of Charles Lindbergh, greatly increased public use of the airmail. By October 1927, the Post Office estimated that the contract service was about 75 percent self supporting.[10]

On January 4, 1928, Congressman Kelly proposed another amendment to the Kelly Act to further aid the aviation industry.[11] The bill included two key provisions: First, instead of the 2-year contracts let by the Post Office or the 4-year maximum prescribed by law, Kelly proposed that airlines should be given "route certificates" which would constitute indefinite contracts for carrying the air mail. Second, the bill decreased the postage rate for airmail from 10 cents to 5 cents for a ½-ounce letter.

The unlimited route certificate proposal was reduced to a 10-year certificate before the bill was adopted as the Act of May 17, 1928. [12] The proposal for route certificates was probably borrowed from the field of public utility regulation. At the time, of course, the air transport industry was engaged in the work of a public utility, the mail service. Kelly hoped to use the promise of route certificates to negotiate lower poundage mail rates from the airlines which rates, in turn, would be feasible by the increased volume of mail stimulated by the lower postal rates. Although the airlines were in favor of the proposal, [13]

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[7] Act of June 3, 1926, ch. 460, 44 Stat. 2.
[8] Paul Theodore David, *The Economics of Air Mail Transportation* 62–63 (1933).
[9] Francis Auten Spencer, *Air Mail Payment and the Government* 35 (1941).
[10] Id. These early routes and airlines are listed in *Hearings on the Post Office Appropriation Bill for 1929 Before a Subcommittee to the House Committee on Appropriations*, 70th Cong., 1st sess., at pp. 287–91 (1928).
[11] H.R. 8337, 70th Cong., 1st sess.
[12] Act of May 17, 1928, ch. 603, 45 Stat. 594.
[13] Hearings on H.R. 7213 and H.R. 8337 Before the House Committee on the Post Office and Post Roads, 72d Cong., 1st sess., at pp. 29–38 (1928).

opposition within Congress forced modification. Congressman Ramseyer explained the reasons for the change:

* * * A lot of people [with] vision [believe we] will have airplanes carrying 50, or 100, or 150 passengers. When that day comes, you will not have just one line, with the main business being mail. When that time comes you will have passenger fleets of planes; carrying air mail will be a minor business. Suppose you have two or three companies with airplanes carrying passengers and goods from New York to San Francisco; well, when that time comes, it will no longer be the chief concern of the Post Office Department to keep some line going; the lines are there. You will not be afraid you have a contractor to carry mail for four years and if you take the contract away he will go out of business. When that time comes, then, of course, you can leave it to competitive bids, as you are now, without injury either to the Post Office Department or the development of aviation. But if you have this contract in perpetuity, and here is a company content to carry nothing but mail, and another company comes along and carries 150 passengers on each plane, and could carry the mail at a trifling amount as compared with the one which devotes all its time to carrying mail, certainly when that time comes you want to be in a position of not being tied up to some firm with which you have a perpetual contract.[14]

The authority to reduce postal rates was passed by Congress as proposed, but it was not used as Congress envisioned. The Act did not technically require the Postmaster General to negotiate lower contract rates and certificates at the same time that lower postage rates were allowed. Lameduck Postmaster General New reduced the postage rates effective August 1, 1928, without disturbing the poundage contracts. The volume of mail suddenly jumped 95 percent. Hence, airline revenue almost doubled. However, airline costs were virtually unaffected since in early 1928 the airplanes were generally less than 20 percent full, and, therefore, an increase in the volume of mail did not require the addition of any more flights. As one airline scholar of the period concluded, "[F]ew groups of business men have seen their economic position change so suddenly and so greatly by the decision of a single administrative official." [15] As a result of inadequate Congressional understanding of airline economics and hastily drawn legislation, those carriers who happened to hold routes on which the volume of mail increased greatly received "excess profits" unrelated to costs or to the original contracts under which they obtained the route. Paul T. David in a 1933 Brookings Institution study calculated the primary beneficiaries to be as shown in table B1.

[14] Id., p. 24.
[15] Paul Theodore David, *The Economics of Air Mail Transportation*, p. 83 (1933).

TABLE B1.—GOVERNMENT CONTRACT PAYMENTS IN EXCESS OF $1 PER AIRPLANE MILE, FISCAL YEAR 1929 [16]

Route	Contractor	Payment per mile	Total payments	Excess payments
Boston-New York	Colonial Air Transport	$2.60	$275,136.56	$169,335.56
Salt Lake City-Los Angeles	Western Air Express	3.20	1,784,407.76	1,226,420.76
Salt Lake City-Pasco	Walter T. Varney	1.56	575,747.84	206,731.84
Cleveland-Pittsburgh	Clifford Ball	2.79	291,484.80	186,995.80
New York-Chicago	National Air Transport	1.06	1,211,340.35	63,508.35
Chicago-San Francisco	Boeing Air Transport	1.45	2,997,885.50	927,422.50
New York-Atlanta	Pitcairn Aviation, Inc	1.52	725,685.84	249,269.84
Total			7,861,688.65	3,029,684.65

Source: Paul Theodore David, "The Economics of Air Mail Transportation," p. 84 (1933).

[16] In fact, the new rate was only in effect for 11 months of the 1929 fiscal year, so that the table understates the rate of excess payments. David calculates that the postal service was only 40 percent self-supporting during this period. Id. at p. 83.

Of these companies, Colonial Air became a prime component of American Airlines; Western Air Express was one of two components of TWA; Varney, National Air, and Boeing Air were the components of United Air Lines; and Pitcairn was the major component of what became Eastern Airlines.

The poundage system of airmail payments also lent itself to much abuse. Crankshafts and telephones were mailed back and forth because the more pounds, the more the Post Office paid the carriers. Two tons of lithograph equipment was airmailed from Niagara Falls to California. Postage was $6,000, Post Office payment to the carrier was $25,000.[17] For the first time, the Government was paying much more for air mail than it received in revenue.

To remedy these abuses and to stimulate the passenger business, which was unprofitable, the Post Office called together all the carriers in May, September and October of 1929. President Hoover seemed to favor a scientific solution—a general formula that would set all rates. Extensive financial audits were undertaken. However, the conference broke up in disagreement which led directly to the Watres Act of 1930.[18]

CONSOLIDATION OF THE AIRLINES UNDER REGULATION BY THE POST OFFICE, 1930–33

The Watres Act of April 29, 1930, was the third, last, and most drastic of the amendments to the Kelly Act of 1925. During its formulation and the four-year period of its effectiveness, the industry came to be almost completely owned by three great holding groups, the forerunners of today's Big Four (American, Eastern, TWA, and United) and Government policy became one of protecting these groups against the independent airline.

The political ingredients which led to the Watres Act may be summarized. First, the airlines had collected a hodgepodge of profitable and unprofitable routes in response to the irrational system of airmail payments authorized by Congress in the 1926 Amendment and exacerbated by the lowering of the postal rates in 1928 and the general public enthusiasm engendered by such spectacular events as the Lindbergh flight. Second, Congress was unwilling to allow the unprofitable carriers to bankrupt.[19] Indeed, no one in the Congress or the industry seemed to want to shed light on who was efficient and who was inefficient.[20] Third, the airlines were politically strong. They were supported by the Hoover administration, the many cities that wanted service regardless of who paid for it, many large companies such as General Motors, Ford, Aviation Corporation, and such popular figures as Charles Lindbergh. Fourth, the Congress was opposed to outright subsidy and fundamentally anticompetitive conduct.

On February 4, 1930, Congressman Watres introduced H.R. 9500. The bill was probably written by the Post Office.[21] It contained the following major elements:

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[17] Hearings on the Post Office Appropriation for 1931 before a subcommittee of the House Committee on Appropriations, 71st Cong., 2d sess., at pp. 243–44 (1929).
[18] Paul Theodore David, *The Economics of Air Mail Transportation*, pp. 88–93 (1933).
[19] Id., p. 100.
[20] Id., p. 93.
[21] Id., p. 95.

(1) To put contracts on a "space-mile" basis rather than a poundage basis. In essence, this method had so little to do with costs and postage revenues that it was a direct subsidy that did not appear to be so.

(2) To retain the 10-year route certificates of the 1928 amendment but to scrap the ceiling on carrier compensation rates in favor of periodic renegotiation by the Postmaster General.

(3) To permit the Postmaster General to extend routes to solve the problem of the uneconomic short routes.

(4) To permit the Postmaster General to award certificates by renegotiation.

The space-mile rate basis was supported by the new Postmaster General, Walter Brown, in testimony that was filled with specious, but complicated, economic argument. After summarizing this testimony, David concludes, "The conclusion is irresistible that the Postmaster General was interested in a peculiar type of equality of compensation, one in which equal payments were to be made for services of unequal value . . ." [22]

The fourth provision listed above, permitting negotiation of contracts without competitive bids, aroused great opposition. The minority report of the House committee pointed out: "This provision making the Postmaster General a law unto himself, eliminates competition, and is nothing more than a subsidy in the interest of the aircraft industry." [23] The opposition forced the bill to be entirely rewritten so that competitive bidding was required. However, they acquiesced in a provision restricting bids to companies who had previously operated daily service over 250 miles for more than 6 months, thereby severely restricting the opportunities for new airlines to gain mail contracts. As modified to require competitive bidding, the Watres Act became law on April 29.[24]

Postmaster General Brown immediately put his new powers to work. Airlines were converted from 2-year contracts to 10-year certificates as rapidly as possible. Of fundamental importance was his decision to create two new transcontinental routes—one through the central part of the country and one across the southern states—to compete with the one extant transcontinental route from New York to San Francisco operated by United Air Lines. These two routes were the key building blocks for TWA and American Airlines, respectively.

Brown apparently intended to evade competitive bidding entirely by calling these new transcontinental routes "extensions." When stymied by a decision of the Comptroller General, Brown carried out his plan by means of an essentially phony competitive bidding.[25]

American Airlines was organized on January 25, 1930, as an intermediate holding company of a large conglomerate called Aviation Corporation which, in turn, held controlling interest in three major subsidiary holding companies (Colonial Airways, Southern Transport, and Universial Aviation) and directly held two other airlines (Interstate Airlines and Alaskan Airways).[26] American submitted the

[22] Id., p. 96.
[23] H. Rept. 966, p. 6, Mar. 24, 1930.
[24] Act of Mar. 29, 1930, ch. 223.
[25] Henry Ladd Smith, *Airways*, pp. 169–71 (2d ed. 1965); Paul Theodore Davis, *The Economics of Air Mail Transportation*, pp. 111–19 (1933).
[26] Henry Ladd Smith, *Airways*, pp. 152–54 (2d ed. 1965); Paul Theodore Davis, *The Economics of Air Mail Transportation*, pp. 128–30 (1933).

maximum legal bid for a contract rate of 75 cents per mile, for the southern transcontinental route. Since it was the only bidder, it was granted the contract.

The central route was awarded to a new company, Trans Western Airlines, which was formed by the merger of Western Air Express and Transcontinental Air Transport. TAT had much engineering ability including Lindbergh and the facilities of one of its holding companies, General Motors. However, it was unprofitable because it lacked a mail contract. WAE was an unusually profitable mail carrier that did not fly east of St. Louis, and did not want to. It had just absorbed two independent western carriers "on the strength of assurances of the Postmaster General." [27] Neither company wanted merger, but both wanted the transcontinental contract and Brown wanted them to join. In the end the companies bowed to Brown 's pressure and were awarded the middle transcontinental contract for a bid of 39 cents per mile. To award the contract to TWA, however, Brown ignored the lower bid of another company which did not comply with certain bidding technicalities.[28]

The story of TWA, however, is more complicated. TAT was a subsidiary of a large holding company organized by a Wall Street financier C. M. Keys, in 1928. Backed by such concerns as General Motors (which gained full control of the holding group in 1933), Hayden, Stone & Co. and BancAmerica-Blair, NAA acquired all types of aviation companies. TAT, which had been organized in 1929 was one.[29] Another was Eastern Air Transport, predecessor to Eastern Airlines, which NAA had bought on July 10, 1929, from Harold Pitcairn, the aviator-pioneer who had founded the company.[30] Eastern and TWA remained affiliated through their joint holding company until March 1938.[31]

In addition to acquisition by the Keys group, the lynchpin to Eastern's success was probably rewinning the New York to Washington, D.C., mail contract in 1931. This was the northern end of Eastern's main line between New York and Miami. In 1931 a low-cost operator, Luddington Lines, bid 25 cents per mile for carrying the mail between New York and Washington. This low bid was premised on establishing a revolutionary hourly shuttle service between the two cities which, Luddington argued, would generate unprecedented passenger traffic that would almost cover the cost of operation. Brown's rejection of Luddington's 25-cent bid and subsequent acceptance of Eastern's 89-cent bid was one of the incidents that led to the establishment of a special Senate investigatory committee in 1933.

The third of the transcontinental operators was United Air Lines. United was the outgrowth of a group of aircraft manufacturers who merged in October 1928 and included Boeing Airplane & Transport Co. of Seattle and Pratt & Whitney Co. of Connecticut.[32] Boeing Air Transport, a subsidiary of Boeing Airplane, began flying operations by winning the Chicago–San Francisco mail contract on July 1, 1927.

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[27] Henry Ladd Smith, *Airways*, p. 174 (2d ed. 1965).
[28] Id. at p. 191. There was some doubt about the validity of this bid and the reliability of the bidding party. See Paul Theodore David, *Economics of Air Transportation*, p. 114, note 11 (1934).
[29] Id. at pp. 141–44.
[30] Id. at p. 219.
[31] Id. at p. 296. A fuller description of the Keys group is contained in Mayer, Meyer, Austrian and Platt, *Corporate and Legal History of United Air Lines and Its Predecessors and Subsidiaries, 1925–45*, vol. 1, at p. 79 (1953).
[32] Henry Ladd Smith, *Airways*, p. 137, 2d ed. (1965).

Although a large, well-managed company from the outset, United's birth as a giant airline dates from March 31, 1930, when it acquired National Air Transport from the orbit of the Keys group. United thereby gained NAT's mail route from New York to Chicago. About the same time, United also acquired Stout Air Services, a small Chicago to Cleveland carrier and Varney Air Lines which operated between Salt Lake City and Seattle.[33]

In addition to encouraging the formation of super airlines, Postmaster General Brown broadly construed and used his authority to "extend" existing lines. Altogether the 1930 system of 20,240 air-mile routes was extended 8,972 miles without the formality of competitive bidding.[34]

While the three large holding groups were being encouraged, the small independent airline was being squeezed out of existence. As Brown explained to his critics:

> Of course they did not all get the basic thought that was back of my policy and that caused the arguments, usually. That thought was this: *that we were not buying peanuts and pencils and pig iron; we were buying a service that was highly specialized and exceedingly hazardous*, and that there was no sense in taking this government's money and dishing it out . . . to every little fellow that was flying around the map and was not going to do anything . . . to develop aviation in the broad sense. But the thing to do was to spend that money so that, if possible, we could develop . . . some people who would compete with each other and bring their aeronautical industry up to a point where it could finally sustain itself. Helping some little fellow make good his losses for a few years and have him no further along than when he started—there was nothing in that; and those were the matters in my talks with them that they did not quite get my point. They seemed . . . to think that I was trying to foster an octopus, whereas what I was trying to do was to get somebody with a big enough personnel, with enough management and money back of it to test this thing out and see whether it was possible to get an air transport company that could live on its own, then there would be plenty of competition.[35]

A good example of a "little fellow" was Erle P. Halliburton who owned Southwest Air Fast Express serving Texas, Kansas, Missouri, and Oklahoma. In November 1929, Halliburton learned of Brown's plans to establish new transcontinental routes and offered to carry the mail coast to coast for $2.10 per pound while the Government was paying $8.77.[36] Halliburton was ignored for as long as possible. In the end Aviation Corporation (American Airlines) agreed to buy out Halliburton for $1.4 million—about double what Halliburton estimated the company was worth—as part of the deal by which the southern transcontinental route was bid. Coincidentally, perhaps, at the same time TWA agreed with Aviation Corporation that, if each was successful in its bid for a transcontinental route, TWA would pay Aviation Corporation $1.4 million in exchange for some Western Air Express stock and "an interest in the hanger and some property in Tulsa [Halliburton's home base]." [37]

The rise of the Big Four airlines of today thus dates from Walter F. Brown's term as Postmaster General. In May 1929 when Brown called

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[33] Id., pp. 132–41. *See also* Mayer, Meyer, Austrian and Platt., *Corporate and Legal History of United Air Lines and Its Predecessors and Subsidiaries, 1925–45*, vol. 1, at pp. 3–262 (1953).

[34] Henry Ladd Smith, *Airways*, app. 4, 2d ed. (1965).

[35] *Hearings Pursuant to S. Res. 349 Before the Senate Special Comm. on Investigation of Air Mail and Ocean Mail Contracts*, 73d Cong., 2d sess., at p. 2580 (1934) (emphasis added).

[36] Id., pp. 1488–1506.

[37] Henry Ladd Smith, *Airways*, p. 194, 2d ed. (1965).

together the airline industry to organize and rationalize it, 24 mail contracts were distributed among approximately 19 independent companies. Three companies received the dominant shares of the $11.2 million mail payments due at least to some extent to the excess payments required by the 1928 poundage method of contract payments: Boeing Air Transport (predecessor of United), National Air Transport (predecessor of United), and Western Air Express (predecessor of TWA).[38]

During Brown's tenure mail payments increased to $19.4 million and the miles of air mail routes increased from 14,406 to 27,678.[39] By the end of 1933 all but 2 of the 20 air mail contracts were held by three large holding groups: United Aircraft & Transport Co. (United), Aviation Corporation (American), North American Aviation/General Motors (TWA and Eastern). These three flew 26,675 of the 29,212 air route miles[40] and collected $18.2 million of the $19.4 million paid to air mail contractors.[41] The other two contracts were held by Northwest Airways of Michigan (predecessor of Northwest Airlines), which had increased from 407 air-miles to 2028 air-miles by noncompetitive extension routes by the Postmaster General, and the minor National Parks Airways holding the 509 mile route from Great Falls, Montana to Salt Lake City, Utah.[42]

The history of the growth of these airlines thus suggests that they were more the product of uneven Federal policies than natural market forces. Of the giant airlines, only United can plausibly assert that it was put together by aviators in response to aviation economics.

American Airlines began as an unprofitable financier's hodgepodge which was saved from failure by a maximum subsidy along a major route and $1.4 million from TWA. Even so, American might well have failed except for the forced reorganization of 1934.[43] Eastern was the outgrowth of the obvious mainline up and down the east coast. Nevertheless, its survival depended upon Brown's willingness to overlook offers to fly the mail for substantially lower contract rates over segments of Eastern's network. All airlines were protected from daily competition by the crucial airmail subsidy and Mr. Brown's incistant vision.[44] Whatever the rise of the Big Four indicates, it is not the story of cut-throat competition among the airlines resulting in a natural ologopolistic solution. and it does not demonstrate that such would be the result of competition in 1975.

SENATE INVESTIGATION AND CANCELLATION OF THE AIRMAIL CONTRACTS—1934

Congressional discontent with the Postmaster General's administration of the Watres Act of 1930 led to the establishment of the Senate Special Committee on Investigation of Air Mail and Ocean Mail

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[38] The list of routes and payments per route is given in *Annual Report of the Postmaster General—Fiscal Year Ending June 30, 1929* at 125 (1929). The list of contractors for each route in operation in 1929 is given in *Hearings on the Post Office Appropriations for 1931 Before a Subcommittee of the House Committee on Appropriations,* 71st Cong., 2d sess., at pp. 150–51 (1929).

[39] *Annual Report of the Postmaster General—Fiscal Year Ending June 30, 1933,* at p. 104.

[40] Henry Ladd Smith. *Airways,* app. 4, 2d ed. (1965).

[41] *Annual Report of the Postmaster General—Fiscal Year Ending June 30, 1933,* at p. 103.

[42] Henry Ladd Smith, *Airways,* app. 4, 2d ed. (1965).

[43] Henry Ladd Smith, *Airways* at pp. 291–92, 2d ed. (1965).

[44] Scholars and judges have disagreed on the motive underlying Brown's actions. Some suspect corruption; others find a determined vision of a newer world. Mr. Brown's motives are irrelevant, however, to the conclusions of this study.

Contracts chaired by Senator Hugo Black of Alabama (later Associate Justice of the Supreme Court). The Black committee generated continual front page news as it collected 2,235 pages of testimony from airline and government witnesses between January 9, 1934, and April 19, 1934.[45] Although the committee never issued a final report, Senator Black's own summary conclusion of this investigation was:

> Since 1925 the taxpayers of this nation have paid $1,143,255,705.30 for the development of aviation. This taxpayers' money has been paid through mail subsidies, the army, navy, Commerce and other departments of the Government.
>
> The tragic part of this picture is that investigations have revealed recently that these huge governmental expenditures have, in great part, found their way into the pockets of profiteers, stock manipulators, political and powerful financial groups who never flew an airplane, who never invented an engine, who never improved an airplane part. In short, this great and indispensable industry was greedily grabbed away from the control of those interested in aviation progress, and has been utilized by profiteers as a means for private gain through stock jobbing, speculation, and monopoly.
>
> Behind each well-known aviation expert there have stood, and now are found, financial and political groups who control aviation in all its branches, by directorates, interlocking directorates, holding companies, associates and affiliates, and whose interest is and has been to make unfair profits and to secure sudden unearned enrichment.[46]

The information that came to light in the Black Committee investigation prompted President Franklin D. Roosevelt to take the extraordinary step of immediately canceling all contracts with airlines and ordering the Army to carry the mail.[47] It soon became apparent, however, that the Army did not have the men or equipment to do the job.

THE EMERGENCY 3-MONTH BID CONTRACTS OF 1934

After 2 months of poor service, frequent crashes, and public outrage over the loss of life, the President advertised for competitive bids for temporary, emergency contracts to carry the mail for 3 months until Congress could write new legislation.[48] The bids were opened on April 20, 27, and May 8.[49] Because of the general disrepute into which aviation had fallen, the temporary nature of the contracts, and the fear of low bids by independent airlines who might take a now-or-never attitude, the bids were low and uneven.

The outcome of the bidding was predictable. The big companies could not be challenged on the long routes since only they had the equipment and experience for immediate service. Each of the big three holding groups (United, American, TWA/Eastern) retained the backbone of its air system. Each lost about 20 percent of its former system to independents. Northwest retained the Fargo to Seattle portion of its Chicago to Seattle route. However, it soon acquired its challenger. The minor line, National Parks Airways, retained its line under the name Alfred Frank until it was sold to Western Air Express in August 1937.[50] Twelve independent newcomers shared about 20 percent of the former system of airmail contracts. The details are contained in table B2.

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[45] *Hearings Pursuant to S. Res. 349 Before the Senate Special Committee on Investigation of Air Mail and Ocean Mail Contracts*, 73d Cong., 2d sess. (1934).

[46] Radio broadcast entitled "Aviation and Air-Mail Contracts," broadcast on CBS radio on Feb. 16, 1934 reported in *New York Times*, p. 6 (Feb. 17, 1934).

[47] Executive Order 6591 (Feb. 9, 1934).

[48] Francis Auten Spencer, *Air Mail Payment and the Government* at pp. 61–62 (1941).

[49] Henry Ladd Smith, *Airways* at pp. 279–82, 2d ed. (1965).

[50] Id.

TABLE B2.—SUCCESSFUL BIDDERS, ROUTES, MILEAGES, DATE OF AWARD, AND RATES OF TEMPORARY CONTRACTS OF 1934 [a]

Contractor and route termini	Route	Mileage	Date awarded	Rate per mile (in cents)	Number of bidders
United Air Lines, Inc. [b]		4,990			
New York-Oakland	1	2,720	May 3	38.0	1
Seattle-San Diego	11	1,242	---do---	39.5	1
Salt Lake-Seattle	12	1,028	---do---	39.5	1
TWA, Inc.: New York-Los Angeles	2	2,613	---do---	24.0	2
American Airlines, Inc.		6,509			
Fort Worth-Los Angeles	4	1,329	---do---	39.5	1
New York-Chicago	7	803	---do---	39.5	1
Boston-New York	18	223	---do---	33.333	1
Boston-Cleveland	21	612	June 2	24.5	3
Cleveland-Nashville	22	469	---do---	14.875	10
New York-Fort Worth	23	1,459	---do---	13.0	2
Washington-Chicago	25	682	---do---	29.0	4
Chicago-Fort Worth	30	932	---do---	8.0	5
Eastern Air Lines, Inc.		3,338			
New York-New Orleans	5	1,213	May 3	19.0	2
New York-Miami	6	1,200	---do---	29.0	1
Chicago-Jacksonville	10	925	---do---	19.0	3
Hanford's Tri-State Airlines, Inc. [c]		1,623			
Chicago-Pembina, N.D.	16	775	May 12	19.6	3
St. Paul-Kansas City	26	848	June 26	18.9	5
Northwest Airlines, Inc.: Fargo-Seattle	3	1,274	May 3	33.75	2
Pacific Seaboard Airlines, Inc.: [d] Chicago-New Orleans.	8	903	---do---	17.5	7
Braniff Airways, Inc.: Chicago-Dallas	9	955	May 4	22.5	3
General Air Lines, Inc.: [e] Salt Lake-San Diego	13	778	May 3	24.0	3
Central Airlines, Inc.: [f] Washington-Detroit	14	464	---do---	23.8	3
Long & Harman, Inc.: [g] Amarillo-Brownsville [h]	15	1,079	---do---	19.75	5
Wyoming Air Service, Inc.: [e]		619			
Cheyenne-Pueblo [i]	17	201	---do---	35.0	2
Billings-Cheyenne	28	418	June 2	28.5	6
Alfred Frank [j]: Salt Lake-Great Falls	19	517	May 7	39.0	1
Robertson Airplane Service Co.: [k] New Orleans-Houston.	20	323	June 26	16.7	5
Delta Air Corp. Co.: Charleston-Dallas	24	1,056	June 8	24.8	3
National Airways, Inc.: [l] Boston-Bangor-Burlington.	27	401	June 5	29.5	1
Varney Speed Lines: [m] Pueblo-El Paso	29	542	June 12	24.0	3
D. K. Franklin and G. T. Baker: [n] Daytona Beach-St. Petersburg.	31	149	---do---	17.0	9
Pennsylvania Airlines & Transport Co.: [f] Detroit-Milwaukee	32	263	---do---	38.9	2
Inter-Island Airways, Ltd.: Honolulu-Hilo-Lihue	33	330	Sept. 27	19.5	1
Grand total mileage and total number of bidders		28,726			102

[a] "Air Mail Compensation," 206 ICC 675, 745–46 (1935); U.S. Post Office Department, Division of Air Mail Service "Preliminary Statistical Report for the Month of October 1934."

[b] Name changed to United Air Lines Transport Corp. in December 1934.

[c] Northwest acquired Hanford's contract on Route 26 in January 1935. Hanford changed name to Mid-Continent Airlines August 1938.

[d] Name changed to Chicago & Southern Air Lines in February 1935.

[e] Name changed to Western Air Express in January 1935 and to Western Airlines in January 1941.

[f] Pennsylvania and Central combined to form Pennsylvania Central Airlines Corp. in February 1937.

[g] Contract acquired by Braniff in January 1935.

[h] Name changed to Inland Air Lines in July 1938.

[i] Cheyenne-Denver portion of route 17 transferred to United Air Lines in October 1937.

[j] Name changed to National Parks Airways in December 1934; contract acquired by Western Air Express Corp. in August 1937.

[k] Contract acquired by Wedell-Williams in January 1935, and by North American Aviation (Eastern Air Lines) in December 1936.

[l] Name changed to Boston-Maine in March 1937, and to Northeast Airlines in November 1940.

[m] Name changed to Continental Air Lines in August 1937.

[n] Name changed to National Airlines in December 1937.

Source: Spencer, Francis Auten, "Air Mail Payment and the Government," pp. 64–65 (1941).

The emergency bids of April and May 1934 are important because subsequent acts of Congress and then the Civil Aeronautics Board have largely frozen the air transport industry into the pattern it assumed during this bidding.

President Roosevelt asked Senators Black and McKellar to draw up interim legislation until a permanent solution could be found. Their bill was introduced on March 9, 1934,[51] and thoroughly revised and reintroduced on March 23, 1934.[52] The Black-McKellar Act, "An Act to Revise Air-Mail Laws and to Establish a Commission to Make a Report to the Congress Recommending on Aviation Policy," became law on June 12, 1934.[53] It was amended once in August 1935 by the Mead-McKellar Act.[54] The major provisions of these acts and their practical effects in the period 1934–38 must be reviewed briefly because they were the precursors to the Civil Aeronautics Act of 1938.

First, the 1934 Act required competitive bidding for new mail contracts—not to exceed 1 year—and curtailed the discretion of the Postmaster General by setting maximum rates for bid (sec. 3(a)). The extension authority of the Postmaster General was also limited to one 100-mile extension per airline (sec. 3(c)). Furthermore, the Act placed a ceiling on the total number of air mail route miles that could be authorized by the Post Office. In fact, however, only four, relatively minor, new air mail contracts were let.[55]

Second, the 3-month emergency contracts could be extended an additional 9 months (sec. 3(g)). However, another section of the Act permitted the Post Office to extend indefinitely contracts which had been discharged satisfactorily (sec. 6(c)). As a result, the 33 contracts let during the emergency biddings were never bid again.

Third, responsibility for determining contract rate modifications was given to the Interstate Commerce Commission which was directed to make yearly reviews. Although this mandate was strengthened by the 1935 Amendment, it was largely ignored by the ICC.[56] The 1934 Act gave the ICC only the authority to reduce rates; the 1935 Amendment allowed them to raise rates to the maximum rate allowed for new bids. The rate regulation by the ICC was slow, irrational, and unworkable.[57] Furthermore, the Post Office, jealous of its loss of authority, effectively used its authority over mail schedules to frustrate ICC rates.[58]

Fourth, holding companies and other intercorporate connections were rendered unlawful (sec. 7). United Air Lines [59] and American Airlines [60] promptly were reorganized and sheared of their connections to various manufacturing companies. TWA and Eastern, however, remained tied through a common holding company, North American Aviation, in apparent violation of the law.[61]

Fifth, the 1934 Act limited the number of *contracts* that one company could hold to one "primary" and two "secondary" (sec. 15). This provision would have required United to give up its Seattle-San Diego route, its second "primary" contract, and American to relinquish 5 of its 8 contracts. The effective date of this provision was twice postponed

[51] S. 3012, 73d Cong., 2d sess.
[52] S. 3170, 73d Cong., 2d sess.
[53] 48 Stat. 933.
[54] 49 Stat. 614.
[55] A.M. 34, Washington, D.C., to Buffalo, N.Y., went to Pennsylvania-Central Airlines. A.M. 35, Huron, S.D., to Cheyenne, Wyo., went to Wyoming Air Service. A.M. 36, Dayton, Ohio, to Chicago, Ill., went to TWA. A.M. 37, Winslow, Ariz., to San Francisco, Cal., went to TWA. M. pp. 136–37.
[56] Francis Auten Spencer, *Air Mail Payment and the Government*, pp. 117–20 (1941).
[57] Id., at pp. 101–227.
[58] Id., at pp. 121–25.
[59] Mayer, Meyer, Austrian and Platt, *Corporate and Legal History of United Air Lines and Its Predecessors and Subsidiaries, 1925–45*, vol. 1, pp. 173–90 (1953).
[60] Henry Ladd Smith, *Airways*, pp. 291–92, 2d ed. (1965).
[61] Id., at pp. 293–97.

by Congress.[62] Finally, the 1935 Amendment specifically exempted United's Seattle-San Diego route and American's Boston-Miami route from "primary" status and saved American by changing the word "contract" to "route" and permitting the Postmaster General to consolidate a number of end-to-end contracts into one route (secs. 3, 15).

Sixth, the 1935 Amendments prohibited the mail carriers from competing with each other "*in any way*" (sec. 12). Edgar Gorrell, president of the Air Transport Association, later described the effect of this provision, "I think the present air-mail law primarily creates a monopoly."[63]

Seventh, the President was authorized to establish a five man commission to study aviation and report to the Congress (sec. 20).

Between June 12, 1934, the passage of the Black-McKellar Act, and June 23, 1938, the passage of the Civil Aeronautics Act, the airlines did not do well financially. Before 1938 aviation technology was not sufficiently advanced to permit profitable passenger carriage.[64] The financial success of the industry was therefore largely dependent upon the mail payments which had become a direct subsidy to the airlines. The Democratic Congress during this period was disinclined to provide support at the levels that existed before the Black Committee hearings in 1934. The decline in subsidy is shown in the following table: [65]

TABLE B3.—AIR MAIL REVENUES AND PAYMENTS TO CARRIERS, FISCAL YEARS 1931–40 [a]

Fiscal year	Estimated postal revenues	Payments to carrier [b]	Excess of payments over revenues	Air Mail handling expense	Excess plus handling expense
1931	$6, 210, 345	$16, 995, 734	$10, 785, 889	$597, 676	$11, 383, 065
1932	6, 016, 280	19, 995, 179	13, 978, 899	3, 776, 188	17, 755, 087
1933	6, 116, 442	19, 454, 980	13, 338, 538	3, 549, 856	16, 888, 394
1934	4, 446, 253	9, 068, 133	4, 621, 880	3, 160, 072	7, 781, 952
Total	22, 789, 320	65, 514, 026	42, 724, 706	11, 083, 792	53, 808, 498
1935	6, 589, 534	9, 053, 789	2, 464, 255	3, 351, 039	5, 815, 294
1936	9, 702, 676	12, 000, 000	2, 297, 324	4, 879, 350	7, 176, 674
1937	12, 439, 579	12, 984, 000	544, 421	6, 193, 129	6, 737, 550
1938	15, 301, 211	14, 741, 249	−559, 962	7, 608, 015	7, 049, 053
Total	44, 033, 000	48, 779, 038	4, 746, 038	22, 031, 533	26, 778, 571
1939	16, 326, 358	16, 767, 934	441, 576	8, 505, 746	8, 947, 322
1940	19, 122, 905	18, 678, 921	−443, 984	9, 360, 328	8, 916, 344
Total	35, 449, 263	35, 446, 855	−2, 408	17, 866, 074	17, 863, 666
Grand total	102, 271, 583	149, 739, 919	47, 468, 336	50, 981, 399	98, 450, 735

[a] Post Office Department, Division of Cost Ascertainment. Figures for 1931–38 are cited in Federal Coordinator of Transportation, "Public Aids to Transportation," 1940, vol. 1, p. 147.

[b] Amounts shown as payments to contractors in the years 1935–40 are subject to final adjustment.

Source: Francis Auten Spencer, Air Mail Payment and the Government, p. 304 (1941).

The payments were not only smaller, they were also adjusted more slowly due to extreme "regulatory lag" within the ICC. The airlines also had difficulty attracting investment capital. This may be attributed to several causes. The public faith in the industry had been severely undermined by the Black hearings. The numerous air crashes also dampened public enthusiasm. Then too, airline dependence on an

[62] Francis Auten Spencer, *Air Mail Payment and the Government*, pp. 332–33 (1941).

[63] *Aviation: Hearings on H.R. 5234 and H.R. 4652 Before the House Committee on Interstate and Foreign Commerce*, 75th Cong., 1st sess., at p. 74 (1937).

[64] Id., pp. 51, 79.

[65] Francis Auten Spencer, *Air Mail Payment and the Government*, p. 304 (1941), argues that the last column is the best measure of the subsidy to the airlines since it represents the excess of the payments to the airlines above the value of the services rendered.

unsympathetic and unpredictable Congress for necessary subsidies restrained investment. Lastly, the general depression of the national economy and the added costs of complying with the National Recovery Act hindered the generation of capital.[66]

EVOLUTION OF THE CIVIL AERONAUTICS ACT OF 1938

The Federal Aviation Commission established by the Black–McKellar Act of 1934 reported to Congress on January 30, 1935. Its report contained 102 recommendations and suggested the establishment of an independent ICC-type commission.[67] President Roosevelt, however, favored extension of ICC authority.[68] For 3 years this legislation was stalled in Congress by doubt over whether or not a separate agency should be established,[69] a general feeling that legislation was not urgent,[70] a feeling that the airlines should stew in their own sins for a while,[71] interdepartmental rivalry within the executive department,[72] and the illness of Senator McCarran, a chief sponsor of the bill.[73]

In the summer of 1937 an interdepartmental commission resolved disagreements within the executive branch, and in early 1938 President Roosevelt agreed to the creation of a separate agency. With the major obstacles removed, Congress quickly passed the Civil Aeronautics Act of 1938 which was signed by the President on June 23, 1938. This speed was possible because the Congress had been considering similar measures for the preceding 3 years. The sponsors were Senator McCarren and Congressman Clarence Lea. Senator Harry S. Truman, chairman of the Senate subcommittee of jurisdiction, was also a prime advocate. The industry position throughout was represented by Edgar Gorrell, president of the Air Transport Associatoin, the trade association of all the 18 air mail carriers.[74]

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[66] Henry Ladd Smith. *Airways*, pp. 286-87, 2d ed. (1965).

[67] Recommendation 102.

[68] Id., p. iv (message of transmittal by the President).

[69] Compare S. 2 with S. 3845, 75th Cong., 1st sess.

[70] Henry Ladd Smith, *Airways*, p. 301, 2d ed. (1965).

[71] Charles S. Rhyne, *Civil Aeronautics Act Annotated*, p. 49 (1939).

[72] 81 Cong. Rec. 8036-86 (Aug. 16, 1937) (remarks of Congressman Mead).

[73] 82 Cong. Rec. 9226 (Aug. 18, 1937).

[74] The Lea bill was H.R. 9738, 75th Cong., 3d sess., introduced 83 Cong. Rec. 3858 (Mar. 4, 1938). The hearings on H.R. 9738 before the House Comm. on Interstate and Foreign Commerce (chaired by Mr. Lea) were held on March 10, 11, 22, 23, 24, 25, 29, 30, 31, and April 1, 1934, and were entitled *To Create a Civil Aeronautics Authority*. H.R. 9738 was reported faborably. Civil Aeronautics Bill, H. Rept. 2254 pt. 1, 75th Cong. 3d sess., on April 28, 1938. Part 2 of this report was a minority report which dissented only on the question of creating a separate agency. H.R. 9738 was debated 83 Cong. Rec. 6406-13, 6501-15, 7064-104, and passed the House, 7104. It was then repassed as a substitute amendment to the Senate version, S. 3845, 83 Cong. Rec. 7104.

Senator McCarran's original bill S. 3659, was introduced on March 11, 1938, 83 Cong. Rec. 3229. Hearings were held before a Subcommittee of the Senate Comm. on Interstate Commerce, chaired by Senator Truman on April 6 and 7, 1938. No report was made. On April 14, 1938 Senator McCarren introduced a revised bill, S. 3845, which took into account changes suggested by Senator Truman in a proposed substitute amendment to S. 3659. S. 3845 was reported favorably without extensive hearings by the Senate Commerce Committee, S. Rept. 1661, 75th Cong., 3d Sess. (Apr. 28, 1930). S. 3845 was debated 83 Cong. Rec. 6626, 6724, 6746-6772, 6847, 6869, and passed, 6879.

Differences between S. 3845 and the House version, S. 3845 as amended by the substitute amendment of H.R. 9738, were worked out in conference. The conference bill passed the House and the Senate and was signed by the President on June 23, 1938.

For the legislative history of the Civil Aeronautics Act as well as a summary of the contents of pertinent bills see C.S. Rhyne, *Civil Aeronautics Act Annotated* (1939).

The major hearings on regulation of aviation preceding those listed above are:

(1) *Regulation of Transportation of Passengers and Property by Aircraft: Hearings on S. 2 and S. 1760 Before o Subcomm. of the Senate Comm. on Commerce*, 75th Cong., 1st Sess. (1937). The resulting report was S. Rep. 686, *Air Commerce Act-1937*. This was the only detailed report on this subject in the Senate. S. 2 was similar to the Civil Aeronautics Act of 1938 except that it provided for extension of ICC authority rather than creation of a separage agency.

(2) *Civil Aeronautics Authority: Hearings on S. 3760 Before the Senate Comm. on Commerce*, 75th Cong., 3d Sess. (1938).

(3) *Aviation: Hearings on H.R. 5234 and H.R. 4632 Before the House Comm. on Interstate and Foreign Commerce*, 75th Cong., 1st Sess. (1937). This hearing contains what is perhaps the best examination of the concept of the certificate of public convenience and necessity.

(4) *Air Mail: Hearings on H.R. 4732 Before a Subcomm. of the House Comm on Post Office and Post Roads* 75th Cong., 1st Sess. (1937).

First, why did Congress establish any regulatory authority at all, rather than permitting open competition? This review will show that, although committee reports mention "destructive competition," this language appears on closer examination to have been boilerplate which was not substantiated by the evidence before Congress. Rather, the driving forces behind the Civil Aeronautics Act of 1938 appear to have been other vaguer concerns such as a presumed similarity between railroads and airlines or a general desire to promote an ailing but promising new industy.

Second, the extent to which Congress intended to preclude or restrict competition by means of the Civil Aeronautics Act of 1938, is addressed. The evidence suggests strongly that there was no Congressional intent to restrict competition any more than was necessary to ensure the safety and reliability of air service for the public. The 1938 Act did not represent a permanent, general repudiation of the American tradition of open competition, nor an attempt to exclude new entrants into the industry, nor a guarantee of success for particular airlines.

The apparent reasons for not permitting free competition are stated in the pertinent Senate and House reports. S. Rept. 686 (1937) from Senator Trumans's committee states:

> In recent years there has been an extraordinary growth of transportation by air. The air lines cover the country carrying over a million passengers a year and much express and mail and are engaged in intensive competition with each other and with railroads and other carriers. *This competition is being carried to an extreme which tends to undermine the financial stability of the carriers and jeopardize the maintenance of transportation facilities and service appropriate to the needs of commerce and required in the public interest and the national defense.* Aviation in America today, under the present laws, proves unsatisfactory to investors, labor, shippers, and the carriers themselves.
>
> The committee has fully considered the fact that during the early stages of air transportation air mail was undoubtedly one of the most important of the factors contributing to its growth and development. The technological advances of recent years together with the rapid increase of air-passenger and air-express patrons has reduced the revenues accruing to the air carriers from air mail from a major factor to an increasingly minor factor. As all present economic regulation is directed solely to conditions appertaining to the carriage of air mail, it must be clearly recognized that the present laws are not only inadequate but obsolete. *The recognized and accepted principles of the regulation of public utilities, particularly as applied to other forms of transportation, have been incorporated in S. 2.* The committee feels that this bill will not only promote an *orderly development* of air transportation in the United States but, by its immediate enactment, prevent the growth of bad practices and uneconomic capital structures resulting from a period of *destructive competition which the testimony shows to be now under way.* [Emphasis added.]

The Senate report thus suggests three bases for regulation: (i) past "destructive competition which the testimony shows to be now under way," (ii) a fear of future "[dis]orderly development" caused by future "destructive competition," and (iii) "the recognized and accepted principles of regulation of public utilities, particularly as applied to other forms of transportation," which apparently refers to regulation of the railroads and the ICC.

The House committee report by Mr. Lea, contains similar language:

> Under existing law there is little economic regulation of air carriers. Routes are awarded not upon the basis of the ability of the particular air carrier to perform the service or the requirements of the public convenience and necessity, but upon the letting of airmail contracts to the lowest responsible bidders. *This system has completely broken down in recent months, because the air carriers, in their desire to*

secure the right to carry the mail over a new route, have made absurdly low bids, indeed have virtually evinced a willingness to pay for the privilege of carrying the mail over a particular route. A route once secured, however, under the existing system of air-mail contracts does not protect the air carrier operating that route from possible *cutthroat competition*, for air carriers are not requiring to secure a certificate or other authorization from the Government before beginning operations, other than one based upon safety requirements. Nor is there any authority in the Federal Government under existing law to prevent competing carriers from engaging in *rate wars which would be disastrous to all concerned*.

The result of this chaotic situation of the air carriers has been to shake the faith of the investing public in their financial stability and to prevent the flow of funds into the industry. *Col. Edgar S. Gorrell, president of the Air Transport Association* representing substantially all of the scheduled American-flag airlines, testified before your committee during the public hearings on H. R. 9738 that $120,000,000 of private capital has been invested in the present air-transport system and that 50 percent of this investment has been lost. He further testified that unless legislation is enacted which would give the carriers reasonable assurance of the permanency of their operation and would protect them from *cutthroat competition*, a number of the air lines would soon be in serious financial trouble. [Emphasis added.] [74a]

The House report thus bolsters the "past cutthroat competition" argument by pointing to the recent low bids for certificates and the decline in investment in the industry.[75]

It seems clear that there was no pre-1938 cutthroat competition. The 1935 amendment prohibited competition between the mail carriers "in any way".[76] As for competition by the nonmail carriers, they were small and few, as Mr. Gorrell admitted,[77] and the mail carriers had the benefit of at least a 15 percent subsidy against their competition.[78] The low bids did not demonstrate cutthroat competition but the defects of the bid system which Mr. Gorrell quite lucidly explicated:

> A moment's consideration of this method of treating the question of compensation will show that it puts a premium upon an unreasonably low bid, since there is always the possibility that, later on, a rate first put unjustifiably low will be raised by the action of the Interstate Commerce Commission. In other words, if an air carrier is in a relatively strong financial position, it can afford to bid at a figure far below what may be reasonable, since the Commission is ultimately under the duty of fixing a reasonable rate. While I do not know that this system has, during our brief experience, worked material hardship, there is the very great danger that it may operate distinctly to the disadvantage of the smaller lines in the future.[79]

Likewise, the decline in investment in the airline industry seems satisfactorily explained by other factors and does not imply cutthroat competition.[80] Indeed, under careful questioning by the House committee, Mr. Gorrell conceded that there had been no significant past competition:

> Mr. SADOWSKI. Do you not think it is true that if, as suggested before, passenger and freight business existed between certain points, that some company would soon spring up ready and willing to take care of that business?
>
> Mr. GORRELL. Perhaps so, sir. But it is not quite so simple as that. For example, I have been talking to a man who spoke about going into the business solely of flying freight, or freight and passengers, or freight, passengers, and express. Now,

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[74a] H. Rept. 2254, pt. 1 (1938).

[75] See also, House Committee on Interstate and Foreign Commerce, *Regulation of Transportation of Property and Passengers by Air Carriers (to accompany H.R. 7273)*, H.R. Rep. No. 911, 75th Cong., 1st sess. at pp. 18–19 (1937).

[76] See p. 207, supra

[77] *Aviation: Hearings on H.R. 5234 and H.R. 4652 Before the House Committee on Interstate and Foreign Commerce*, 75th Cong., 1st sess., at p. 73 (1937).

[78] *Regulation of Transportation of Passengers and Property by Aircraft: Hearings on S. 2 and S. 1760 Before a Subcommittee of the Senate Committee on Interstate and Foreign Commerce*, 75th Cong., 1st sess., at p. 434 (1937). Mr. Gorrell stated that mail revenue was about 30 percent of total revenue, Table B3 indicates that approximately one half of mail revenue was subsidy.

[79] Id., p. 464.

[80] See pp. 207–98, supra.

not many people are willing to go into that business today and put their money into it, thus making an investment, unless there is some proper protection against fly-by-night companies whereby such irresponsible companies cannot come along with a lot of second-hand planes and cut prices right out from under legitimate operators. A system that permits such an operation gives no protection for an orderly growth of the business between the points to be served.

Mr. SADOWSKI. *Has that been done on very many occasions?*

Mr. GORRELL. *No; but it has been much closer than I would like to talk about. I have been shaking in my boots very recently on this subject.*[81]

Furthermore, the liberality with which "destructive competition" seems to have been used during the debate leading up to the Civil Aeronautics Act is suggested by the fact that the operative language of the Senate Report No. 686 (1937), quoted above—"In recent years . . . public interest"—was copied verbatim from a 1935 Senate report dealing with a predecessor bill.[82]

The evidence for future cutthroat competition necessarily consisted primarily of the expert testimony of Mr. Gorrell. His explanation of how future competition would occur and the form it would assume follows:

Mr. SADOWSKI. *I was just wondering whether this business, like every other business, would not develop accordingly as the freight and passenger business was available for it to handle.*

Mr. GORRELL. There is plenty of business available, but, of course, it takes a great deal of money to go into the business on a sound basis and to get the proper type of airplanes. Suppose a businessman wishes to go into the business of handling freight and passengers on lines between points A and B. He must invest a certain number of millions of dollars in the air-line business before he can arrive at the point where he can operate efficiently and safely. *Naturally he does not want somebody to come in and cut the business right out from under him, someone with but little investment and with practically nothing but second-hand planes, or perhaps with only one or two used planes, and cut the rate along his line right at the time he is getting started.* No sensible businessman is going into that kind of a venture.* * *

Mr. SADOWSKI. Nevertheless, whether we should have certificates of convenience and necessity or not, we have found that there has been a tremendous development and increase in this business during the last few years.

Mr. GORRELL. Oh, yes, indeed, sir; but only along certain air-mail lines. Many cities are still deprived of that same service.

Mr. SADOWSKI. Can we not expect the same development in the next 4 years, or 10 years, if the business is there to warrant it, without the necessity of going into the issuance of certificates of convenience and necessity?

Mr. GORRELL. I am not sure of that. I think you will get a certain amount of development, but whether it would be orderly or disorderly I do not know. I personally feel that it will be disorderly. I feel that the losses will be tremendous, I feel that the air-mail carriers, having then lost additional money, would be forced to call upon the Government to make up such losses. The Government would be forced to increase air-mail payments to cover the losses resulting because somebody else wanted to go into the business and cut rates. Today there is absolutely no regulation, from a commercial point of view, of those air lines who do not carry the mail.

Mr. PEYSER. Is there not regulation by the Department of Commerce?

Mr. GORRELL. From the safety standpoint.

Mr. PEYSER. That would prohibit the chiseler, for instance, from using a second-hand plane?

Mr. GORRELL. No.

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[81] *Aviation: Hearings on H.R. 5234 and H.R. 4652 Before the House Committee on Interstate and Foreign Commerce*, 75th Cong., 1st sess., at p. 76 (1937) (emphasis added).

[82] Senate Committee on Interstate and Foreign Commerce, *Report to Accompany S. 3420*, S. Rep. No. 1329, 74th Cong., 1st sess., at p. 2 (1935), reprinted in *Regulation of Transportation of Passengers and Property by Aircraft: Hearings on S. 2 and S. 1760 Before a Subcommittee of the Senate Committee on Interstate and Foreign Commerce*, 75th Cong., 1st sess., at p. 63 (1937).

Mr. PEYSER. *That is, the chiseler may use a second-hand plane?*

Mr. GORRELL. *The second-hand airplane, from the point of view of the Commerce Department, may be safe.*

Mr. PEYSER. They could not use it if it were not safe?

Mr. GORRELL. The Commerce Department checks on the safety.

Mr. PEYSER. Would not that involve safety, if the plane were not equipped properly and was not of the proper type?

Mr. GORRELL. *The second-hand plane can be perfectly safe, but still not be modern from the standpoint of equipment,* and much cheaper to buy than the plane it is competing with.

Mr. PEYSER. But you mean it would comply with all the requirements as to safety?

Mr. GORRELL. I mean to say this: For example, suppose you have an air line operating from A to B. Suppose that line is getting 30 cents a mile from the Government for carrying the mail, on which it may realize some profit, or at least break even. Someone then comes into the business with an old, second-hand plane, still safe, perhaps, but far inferior, and seeks to fly passengers and express and freight at cut rates, thinking perhaps they can make a little more out of such a business. They thus offer to furnish service at a rate based on inferior equipment. *Such may result in getting the passengers and cargo carried at a lower rate in the inferior kind of plane—one that, though safe, is not modernly equipped, and may be owned by a company that pays its pilots less—thus selling service at a rate less than the carrier is entitled to fairly charge.* Then——

Mr. PEYSER. Would it necessarily follow that the Post Office Department would give the contract to the company whose airplanes were poorly equipped?

Mr. GORRELL. I do not know whether it would or not, but it may have that result.

Mr. PEYSER. It would be up to the Department, would it not?

Mr. GORRELL. And the mail carrier would soon be in bankruptcy, sir. The chiseler does not last in this business; the chiseler goes out of business very quickly but he may create business disorder while he lasts.[83]

The evidence that the airline industry was economically similar to the railroad industry rested primarily upon the unchallenged assertions of Mr. Gorrell and Joseph Eastman, Chairman of the Interstate Commerce Commission.[84] Modern economic analysis seems to clearly disprove this analogy.[85]

In addition to this review of the stated reasons for regulation and the evidence before Congress, two further points should be mentioned. First, in 1938 Congress and the industry had had no experience with commercially viable passenger air transport. Nevertheless, the Act attempts to provide for the regulation of an industry that would soon be dominated by the passenger business. Second, Congress had had no experience with a substantially unregulated airline industry. The airline industry, with minor exceptions, was an offshoot of a public utility, the U.S. Post Office, and had always been regulated.

In light of these considerations the subcommittee can only conclude that to the extent that Congress in 1938 intended to restrain free competition in the airline industry, its judgment was based primarily upon evidence of past or potential "destructive competition" which evidence appears in retrospect to have been without any substantial foundation.

The second separate question is to what extent Congress intended to restrain competition within the regulatory scheme established by the Civil Aeronautics Act of 1938. The Act itself directs the CAB to consider as being in the public interest, among other things, "compe-

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[83] *Aviation: Hearings on H.R. 5234 and H.R. 4652 Before the House Committee on Interstate and Foreign Commerce*, 75th Cong., 1st sess., at pp. 77–78 (1937) (emphasis added).

[84] *Regulation of Transportation of Passengers and Property by Aircraft: Hearings on S. 2 and S. 1760 Before a Subcommittee of the Senate Committee on Interstate and Foreign Commerce*, 75th Cong., 1st sess., at p. 513 (1937).

[85] See generally, Almarin Phillips, ed., *Promoting Competition in Regulated Markets* pp. 13–98 (1975).

tition to the extent necessary to assure the sound development of an air transportation system properly adapted to the needs of . . . domestic commerce of the United States. . . ." [86]

The report of the Federal Aviation Commission in 1935 was a seminal influence in the creation of the CAB. Its discussion of the appropriate level of competition under a regulatory authority is contained in recommendation 9. Excerpts follow:

(9) It should be the general policy to preserve competition in the interest of improved service and technological development, while avoiding uneconomical paralleling of routes or duplication of facilities.

We have been fully convinced by all that we have seen and heard that the present high quality of American air transport is due in large part to the competitive spirit that has existed throughout its development.

* * * * * * * *

On the other hand, too much competition can be as bad as too little. To allow half a dozen air lines to eke out a hand-to-mouth existence where there is enough traffic to support one really first-class service and one alone would be a piece of folly. * * *

There must be enough competition to serve as a spur to the eager search for progress, but there must not be so much as to raise costs materially through the duplication of facilities. *There must be no arbitrary denial of the right of entry of newcomers into the field where they can make an adequate showing of their readiness render a better public service than could otherwise be obtained.* There must be no policy of a permanent freezing of the present air transport map, with respect either to the location of its routes or the identity of their operators. *The present operators of air lines have no inherent right to a monopoly of the routes that they serve.*

It must be left perfectly clear that this is a practical problem, to be approached in a practical spirit and without doctrinaire restrictions. We can formulate no general rule. [Emphasis added.]

These remarks should read in light of the report's explanation of why entry was limited in the first place, recommendation 5:

(5) All regular domestic scheduled transport operations should require a certificate of convenience and necessity, to be issued by the commission hereinafter proposed. Such certificates should not be cancelled except for good cause without equitable compensation to the holder.

To permit an orderly development of air transportation and adequately to safeguard its patrons, two fundamental conditions should be met. *There should in the first place be maintained, in the interest of safety, certain minimum standards of equipment, operating method, and personnel qualifications.* Of that we have more to say elsewhere (page 77). A second condition scarcely less important, however, is that *there should be a check in development of any irresponsible, unfair, or excessive competition such as has sometimes hampered the progress of other forms of transport.*

To be specific, where a service of high quality exists, with governmental support and under governmental control, and where there is just enough traffic to justify its existence, it seems to us plainly destructive of the general welfare that a new operator should be permitted to appear on the same route with an inferior service and to wean traffic away form the established enterprise by rate-cutting. It is, for example, much less expensive to run an air line by day only than on a day-and-night basis. Cheaper equipment can be used, and relatively less of it, and the ground organization can be immensely simplified. It is then clearly unfair that a service running both day and night schedules should have to face the competition of one that eaters the field in the cheapest possible fashion and skims the cream of the daytime traffic by offering the lowered rates which are possible through a total omission of any expense relative to preparation for night flying. *The ultimate result in such a case is likely to be that both lines will be wrecked, or if one ultimately survives it will survive on a very inferior plane of service.* In exactly the same way, it seems objectionable and unfair to allow seasonal operations to come into competition with those undertaking to maintain a year-round service. (Emphasis added.)

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[86] Sec. 102. 49 U.S.C. sec. 1302 (1970). The committee reports do not elaborate upon this rather spare standard.

Putting the two statements together, it seems fair to summarize the Commission's proposal as follows: Competition should be prohibited only if it results in service which is unsafe, highly wasteful, destructive of all service, such that it will result in very inferior service; however, competition should be allowed if it may result in better service even if the incumbent airlines are injured financially, for they have no right to protection from one who is ready to provide a better public service.

Senator McCarran's views are well articulated by his testimony before Senator Truman's subcommittee on April 12, 1937. He was concerned with refuting testimony by Karl A. Crowley, Solicitor, Post Office Department, on March 11, 1937, in which Mr. Crowley warned against requiring certificates of public convenience and necessity.[87] Senator McCarran quotes Mr. Crowley's basis objection and responds as follows:

> Mr. Crowley said, at page 118 of the printed hearings:
>
> "*This bill would freeze the present air service. It would create a monopoly with present contractors. No little fellow with a new idea, with plenty of capital, could go out and establish a line from,* say, Wyoming to California. He would have to get a certificate of convenience and necessity before he could do it. The law right now does not prohibit an independent citizen from establishing an air line—an air transport line—at all. If you prohibit that sort of thing, then air transport lines would not be established except by air-mail carriers. Of course, the cost to the Government would be prohibitive.
>
> *This statement could not be made on the basis of an unprejudiced reading of the bill.* It is true that there is nothing in existing legislation to prohibit an individual citizen from establishing an air line. But it is likewise true that *in the proposed bill there is nothing to prevent "a little fellow with a new idea, with plenty of capital" from establishing an air line. The certificating procedure does nothing except to prevent someone with inadequate facilities, or without responsibility, from entering the public service, and to prevent the inauguration of service when it would be unjustified.* The principle of convenience and necessity is indispensable if we are to have adequate transportation. *It is not the principle of monopoly. It is the principle of order, economy safety, and adequacy of service.*"[88]

Senator McCarran's standard thus appears to be that competition was to be prohibited only if it threatened the "order, economy, safety, [or] adequacy of service."

Senator Truman's attitude on this issue is revealed in the following exchange during the hearings with Mr. Crowley.

> [Senator Truman]. *After all, should we permit any Tom, Dick, and Harry to go ahead and put in an air line, whether he is competent to run it or not, whether he has proper facilities to do it or not?* Should there not be some regulation in some bureau to say whether or not a man has got *ships that are capable* of performing the service, whether or not they are *safe*, and whether or not *there should be a particular locality an air line established? * * * After all, we are not interested in the individual fellow who wants to go into the business, but we are interested in protecting life and property on the roads and seeing that "fly-by-night" operations do not start up and bring down prices and create chaos. That is the theory upon which Congress has been going with reference to trucks and busses and railroads and everything else.* That may be a wrong theory, but that is the theory that we have been going on.
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> * * * * * * *
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> Mr. CROWLEY. I do not believe [the President] has gone far enough to say that competition should be throttled in this industry.
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> The CHAIRMAN. *There is no competition being throttled in this industry? How are we throttling competition?*

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[87] *Regulation of Transportation of Passengers and Property by Aircraft: Hearings on S. 2 and S. 1760 Before a Subcommittee of the Senate Committee on Interstate and Foreign Commerce*, 75th Cong., 1st sess., at p. 118 (1937). The bill under discussion was S. 2 which was similar to the eventual Civil Aeronautics Act except that it provided for regulation by the Interstate Commerce Commission rather than a separate agency.

[88] Id., pp. 409–410 (emphasis added). See also, Senator McCarren's remarks at 83 Cong. Rec. 6852 (May 13, 1938).

Mr. CROWLEY. If you will read this bill, you will see that nobody in the world can ever carry the mail except the present air-mail contractors.

The CHAIRMAN. Not at all. According to your own statement, they have to come and get a certificate of convenience and necessity. The truck people are constantly adding new trucks and having new truck lines.

Mr. CROWLEY. *If I am not mistaken, the air mail service is confined exclusively to the present air-mail operators.*

Senator MCCARRAN. *No.*

The CHAIRMAN. *Show me that provision. If that is true, it ought to be changed.*[89]

Senator Truman thus appears to have intended to "throttle" competition only to the extent that it would threaten the safety, competence, or reliability of the service provided; it seems clear that the did not intend to give special protection to the "individual fellow" whether new company or established incumbent airline.

Lastly, it should be noted that the airlines' representative, Mr. Gorrell, several times assured inquiring congressmen that the effect of the new act would be to increase competition and the number of airlines.

Mr. MARTIN. If your association comprises 18 air lines, scheduled lines, and there are only about six others, that would apparently give to the members of your association a virtual monopoly. Why is it concerned for a change which would bring into the field a larger number of carrier companies which would set up competition with those now in this association?

Mr. GORRELL. We feel that the enactment of H.R. 5234 will bring in a number of new companies and there will be additional air-line service.[90]

The intent of the 1938 Act with respect to competition must be construed in light of the extreme Congressional discontent with Government protection of the big airlines manifested in the Black hearings of 1934. In 1934 Congress took half the responsibility of regulating the airlines away from the political executive departments because the large airlines were being unfairly protected against the small independents. In 1938 the entire responsibility was placed in the hands of what Congress conceived of as a fair, impartial body. Their intent was to protect the small and new airlines against the big airlines while at the same time protecting the public against competition which would erode safety or impair the reliability of the air service for the public.

From the above evidence, it appears that the intent of Congress embodied in the Civil Aeronautics Act of 1938 was probably to preserve competition and promote new entrance into the airline industry to the extent that it would not significantly impair the safety, competence, or reliability of air service to the public. There is no evidence that Congress intended to give special protection to individual airlines, whether existing or potential.

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[89] *Regulation of Transportation of Passengers and Property by Aircraft: Hearings on S. 2 and S. 1760 Before a Subcommittee of the Senate Committee on Interstate and Foreign Commerce*, 75th Cong., 1st sess., at pp. 303–05 (1937) (emphasis added).

[90] *Aviation:* Hearings on H.R. 5234 and H.R. 4632 Before the House Committee on Interstate and Foreign Commerce, 75th Cong., 1st sess., at p. 75 (1937).

II. CAB'S REGULATION OF ENTRY BY NEW AIRLINES AND CONGRESSIONAL RESPONSE, 1938–74

MAJOR CHANGES IN THE DOMESTIC PASSENGER AIRLINE INDUSTRY, 1938–74

The domestic passenger airline industry has grown dramatically in 35 years. Domestic revenue passenger miles increased from 476 million in 1938[91] to 128 billion in 1974,[92] an increase of 269-fold. Investment in the domestic airlines increased almost as much, from $30 million[93] to $8 billion.[94] Even these enormous figures understate the change, however, for, as we have seen, before 1938 there was no significant commercially viable passenger business. It can be observed that the *entire* passenger airline business, which in 1974 carried 190 million[95] passengers and collected *$8.5 billion* in fares,[96] has grown up under the regulatory eye of the Civil Aeronautics Board.

In 1938 there were 19 domestic airlines who were given "grandfather" rights by the Civil Aeronautics Act.[97] They may be divided into three groups:

TABLE B4.—DOMESTIC AIRLINES CERTIFIED IN 1938

Grandfathers who held mail contracts prior to 1934:	
United Air Lines	American Airlines
TWA	Western Airlines
Eastern Airlines	Northwest Airlines
Pennsylvania-Central	Inland Airlines
Grandfathers who obtained mail contracts in the emergency bidding in 1934:	
Chicago & Southern	Boston-Maine
Braniff	Mid-Continent
Continental	National Airlines
Delta	
Grandfathers who did not hold mail contracts in 1938:	
Canadian Colonial Airways	Mayflower Airlines
Marquette Airlines	Wilmington-Catilina

Source: Hearings Pursuant to S. Res. 349 Before the Senate Special Comm. on Air Mail and Ocean Mail Contracts, 73d Cong., 2d sess., at p. 492 (1934).

Of the 8 pre-1934 grandfathers, 6 operated in their own names in 1974. Inland, the old National Parks Airways, never grew into a large airline; it was acquired by Western, the successor to Western Air Express, formerly affiliated with the TWA/Eastern holding group before 1934. Pennsylvania-Central, renamed Capital Airlines, became a major airline with 7,500 miles of routes. Because of extreme financial difficulties, the CAB allowed it to merge with United in 1961.

[91] CAB, *Domestic Route System: A Staff Study by the Bureau of Operating Rights*, p. 16 (1974).
[92] CAB, *Quarterly Economic Report: December 1974*, pp. 7, 11.
[93] CAB, *Domestic Route System: A Staff Study by the Bureau of Operating Rights*, p. 16.
[94] CAB, *Quarterly Economic Report: December 1974*, pp. 6, 10.
[95] CAB, *Air Carrier Traffic Statistics*, p. 5 (Dec. 1974).
[96] CAB, *Quarterly Economic Report: December 1974*, pp. 7, 11.
[97] *Hearings Pursuant to S. Res. 349 Before the Senate Special Comm. on Air Mail and Ocean Mail Contracts*, 73d Cong., 2d sess., at p. 492 (1934).

Four of the old "independents" who benefitted from the 1934 bidding still operated in their own names in 1974. They are Braniff, Continental, Delta, and National. Each of the other three was acquired by one of the surviving four.[98]

None of the new 1938 grandfathers survived in 1974. Only one was of substantial size, Canadian Colonial Airways, which flew between Boston and Montreal. It was hurt badly by the loss of certain Canadian operating rights. Other causes for its decline may have been inefficiency, as suggested by the CAB, or discriminatory treatment by the CAB, as alleged by the company.[99] Canadian Colonial, renamed Colonial Airways in 1952, was acquired by Eastern Airlines in 1956.

The development of large scale, regularly scheduled passenger air transport has, in turn, spawned the development of a number of fringe industries including the local, "feeder" service to the main airline terminals, the irregularly scheduled and charter airlines, the commuter service provided by air taxis and helicopters, the private business airplanes, and the all cargo airlines. The most important of these are the first two, the "feeder fringe" and the "irregular fringe."

ENTRY OF NEW AIRLINES

Over the long run the most important kind of competition is that generated by the influx of new blood, the independent and innovative of each successive generation. The focus of our historical review is therefore CAB regulation of potential new entry into the airline industry.

A new company might enter the passenger airline business in either of two ways. It could directly challenge the incumbent airlines by obtaining a certificate of public convenience and necessity from the CAB and conducting major scheduled service in competition with the incumbents. Secondly, it could begin as a small company in a fringe area and, if the boundary between the fringe and the main industry is sufficiently porous, grow into a company which offers more and more regularly scheduled air service. CAB regulation of each of these possibilities and the Congressional response is described below.

NEW CERTIFICATES FOR TRUNKLINE AUTHORITY

The CAB has never granted a certificate to a domestic airline to compete against a domestic grandfather carrier on an equal basis, that is, the CAB has never granted "trunkline" authority.[99a] Nor has the CAB ever articulated standards under which such authority might feasibly be obtained.

Between 1950 and 1974 the CAB received 79 applications for domestic trunkline certificates. In addition, on July 15, 1952, it dismissed 75 applications by irregular carriers, many of which sought trunkline authority.[100]

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[98] Chicago & Southern was acquired by Delta in 1953; Boston-Maine changed its name to Northeast in 1941 and was acquired by Delta in 1972; Mid-Continent was acquired by Braniff in 1952.

[99] *Airline Industry Investigation: Hearings Pursuant to S. Res. 50 before the Senate Comm. on Interstate and Foreign Commerce*, 81st Cong., 1st and 2d sess., at pp. 508, 1511–16, 1653–1771 (1949–50).

[99a] Wright Airlines might be considered an exception. Wright holds a temporary certificate to serve Cleveland, Detroit, and Columbus. (CAB Orders 69–8–165 (Aug. 29, 1969); 72–2–52 (Feb. 14, 1972).) In 1972, Wright's total revenues were $731,000 and rpm were 2.6 million (CAB, *Handbook of Airline Statistics*, at pp. 163, 273 (1973, ed.).)

[100] CAB answer to subcommittee questionnaire, question 13, reprinted in the appendix to the hearings. Of the 94 trunkline applications listed, 15 are exclusively foreign and therefore not counted in the text.

The genesis of this de facto policy may be traced to a 1941 CAB case in which the Board stated:

> The number of air carriers now operating appears sufficient to ensure against monopoly in respect to the average new route case, and we believe that the present domestic air-transportation system can by proper supervision be integrated and expanded in a manner that will in general afford the competition necessary for the development of that system in the manner contemplated by the act. In the absence of particular circumstances presenting an affirmative reason for a new carrier there appears to be no inherent desirability of increasing the present number of carriers merely for the purpose of numerically enlarging the industry.[101]

On March 31, 1942, the Senate responded to this apparent disregard of Congressional intent by passing the "George Resolution" which read:

> Resolved, that the Civil Aeronautics Board be requested, if not inconsistent with the public interest, to report to the Senate of the United States at the earliest possible date what, if any, steps it has taken since 1938 to see that a great many more transport aircraft were built and in service, whether the air transport industry has been, since that date, and is financially able to undertake expansion far beyond its present extent, and what steps the Board contemplates taking to see to it that the air-transport industry is able to and will develop in the future at the maximum possible rate (including the steps the Board contemplates taking with respect to the issuance, under Section 401 of the Civil Aeronautics Act of 1938, of certificates of air carriers who were not engaged in air transportation on the date of enactment of such Act).[102]

The portion included in parentheses was added by separate amendment by Senator Pat McCarren.[103]

On May 8, 1942 Chairman Pogue of the CAB answered the Senate's questions concerning entry to the airline industry as follows:

> Cases involving the application for authorization of new service by persons not engaged in air transportation on the date of enactment of the Civil Aeronautics Act have received and will continue to receive the same careful consideration as is given to applications of existing air carriers. Where the evidence introduced at hearings shows that services applied for by companies not engaged in air transportation on the date of enactment of the act are required by the public convenience and necessity and that services by such new carriers rather than by some other applicant would best serve the public interest, the routes will be awarded to the new carriers.
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> * * * * *
>
> *In this rapidly growing industry there should and will be continuing opportunities for the services of new operators where proper showing is made in conformity with the standards set forth in the act.* These opportunities may present themselves not only in the fields and forms of air transportation already known but in additional fields where new techniques and developments (such, for example, as in the field of air cargo, involving both an expanded market and new forms of equipment) show growth to be justified. *It is only required that there be no uneconomical, mushroom-like growth and that there be no wasteful competition, factors which are inconsistent with the requisite showing of public convenience and necessity.*[104]

In the late 1940's and the early 1950's the argument over the "irregular carriers" again focused attention on the failure of the CAB to certificate any new trunk carriers. The most extensive hearings on the question were conducted by the Senate Select Committee on Small

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[101] Delta Air Corporation, et al., Certificate of Public Convenience and Necessity, 2 CAB pp. 447, 480 (1941).

[102] S. Res. No. 228, 77th Cong., 2d sess. (1942). See also the discussion of the "Irregular fringe," pp. 231–49, infra.

[103] 88 Cong. Rec. 3221 (Mar. 31, 1942).

[104] *Transport Aircraft Production: Letter from the Chairman of the Civil Aeronautics Board Transmitting in Response to Senate Resolution No. 228, a Report on Transport Aircraft since 1938 and plans for Future Development of the Air-Transport Industry*, S. Doc. No. 206, 77th Cong., 2d sess. (1942).

Business. In 1953 the committee issued its second report, submitted by Senator Sparkman, which concluded:

The fundamental issue in this case involves the right of entry of new businesses into an industry. Freedom of opportunity has always been a basic American economic doctrine. Congress has placed limits on that freedom only with great reluctance.

The Civil Aeronautics Act of 1938 represented a limit on that freedom. When that act was passed, the aviation industry was an infant industry with very shaky economic foundations. In order to develop this industry, Congress gave the Civil Aeronautics Board the right to protect the then existing companies from competition until such time as they became strong. *Never in the hearings nor the floor debate on the legislation was there any indication that Congress intended to bar all future entry into air transportation. In fact, the record is filled with repeated assurances that the door would still be open to new companies.*

In the 15 years since the act was passed, the Board has refused to certificate any new carrier to perform common carriage of passengers on the trunk routes.

* * * * *

In light of the evidence brought out in its extensive hearings the Senate Committee on Small Business is confirmed in its previously expressed conclusions that *the door should be kept open in the development of our commercial air-transportation system. We firmly believe this would be in the public interest no less than in the interest of the small-business segment of the aviation industry, here represented by the irregular airlines.*[105]

The report also called for an investigation of the CAB "with particular emphasis on the problem of entry of new operators." [106]

In 1954 the Senate Committee on Interstate and Foreign Commerce conducted extensive hearings on the CAB, prompted by an omnibus revision bill introduced by Senator McCarren. Although the committee did not adopt a report, a staff draft concluded that the calls for freer entry were much exaggerated:

The more limited charge that the Board has certified no new domestic trunklines since 1938 seems to place an undue emphasis on the "trunkline" label. It was contended during the hearings that an analysis of the underlying facts and of the growth of today's trunklines since 1938 would indicate, not a restriction of entry, but a positive development of entry to this field. Thus, Chairman Gurney agreed that some 6 or 7 of the 13 trunklines were actually local-service carriers in 1938, and that many of today's trunklines were actually smaller than the 14 local-service carriers, as they exist in 1954.[107]

* * * * * * *

The basic issue with which the committee is presented here has been posed at an early point in the report—i.e., whether the policy of regulated competition set forth in the Civil Aeronautics Act should be maintained. *There is no support, so far as the record is concerned, for the abandonment of this policy for one of unlimited entry into the air transport business.*[108]

In 1956 the House Committee on the Judiciary conducted the most thorough review of the Civil Aeronautics Board to that date. On the question of new entry the 358-page report submitted by Chairman Emmanuel Celler concluded as follows:

* * * *the committee feels the development and promotions of a sound commercial transportation system would best be assured by resolving indstury problems, to the maximum extent practicable, in favor of increased competition* among the carriers rather than by reliance upon direct regulatory control. This view is supported by the acknowledgment given to competitive values enunciated by the Civil Aeronautics Board in its report entitled, *The Role of Competition in Commercial Air Transportation* [submitted to the Senate Comm. on Small Business in 1952].

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[105] Senate Select Comm. on Small Business, S. Rep. No. 822, 83d Cong., 1st sess., at pp. 18–19 (emphasis added).

[106] Id. at p. 19.

[107] Senate Comm. on Interstate and Foreign Commerce, *Aviation Study on S. 2647*, S. Doc. 163, 83d Cong., 2d sess., at p. 33 (staff report, 1954).

[108] Id. at p. 54.

Not only do the physical and economic characteristics of air transportation support the conclusion that competition should occupy an important position in the regulatory scheme, the structure of the act and its legislative history affirms this viewpoint.

* * * * *with respect to the crucial competitive question involving the ability of new carriers to enter into the industry, it is clear that Congress in 1938 did not intend that air transportation would be reserved to the carriers qualified for certificates of public convenience and necessity at that time.*[109]

Between 1957 and 1974 it appears that the Congress did not undertake another comprehensive review of the CAB's practices with respect to new entry into the trunkline domestic passenger air transport industry. After 1960 the CAB declined to hear most applications for trunkline authority. Of the 32 applications filed between 1960 and 1974, 4 were given hearings and denied, and 28 were held on the docket for 3 to 4 years and then "dismissed as stale." Another 6 were "voluntarily withdrawn" after being held on the docket for an average wait of more than 2 years.[110]

LOCAL SERVICE CARRIERS: THE "FEEDER" FRINGE

Today's "local service" carriers began as the result of pressure from small towns that wanted air service and pilots returning from the war who wanted to fly. CAB Member Josh Lee later recalled this situation:

In 1944, we held our first feeder-route case and certificated two feeders in the Rocky Mountain area, and from that time we have been seeing these feeders develop. I would like to indicate the year-by-year developments from 1946, the first full year of operation after they were certificated. When we looked over the field we said where can we put a new airline? Now we did not say that of our own motion, but we had applications from boys, some of them back from the front, and others that had grown up after their older brothers had gone off to war, they were operating little single-engine planes, and they wanted to operate from "A" to "B." And they believed that there would be traffic if we permitted them to operate. The pressure continued from all parts of the country. We decided maybe we ought to look into this, so we held an investigation, and we had them all come in and the communities got interested and they sent representatives and out of that we made a report, and then we held our first case and they have quoted from the opinion in that case this morning.

Now, we concede this feeder airline is a secondary type of air transportation, not the standard conventional trunk type. It differs in two major respects. One, it does not allow of competition. *The Board could not, without going back on everything it said, certificate these carriers to compete with the trunks. Sure, we could make some of them whole by one stroke of the pen by giving them the route extensions, but we could not do that without going back on everything we have said to the trunks.*

We said in one of those cases we do not propose to allow these carriers to metamorphose into trunklines. They are feeder lines. They are local service lines.

The Board decided that we have to write restrictions into their certificate to provide a local type of service as distinguished from the certificates the trunks have.

Now, there is another difference. They are confined to a certain trade area. That was the concept. A trade area is difficult to define or to always stay within, but one feeder does not extend over into the territory of another feeder, nor do they compete with each other with the trunks.

As a result, some of the trunks have given us cooperation and cooperated with he feeders in giving up willingly in some cases the towns to be transferred to the feeders for service on the theory and belief that we would stay with our statement that they would not compete. So we set them up as feeders and ascribed to them an area in which they are to provide the local service.[111]

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[109] House Comm. on the Judiciary, *The Airline Industry: Report Pursuant to H. Res. 107*, H.R. Rept. No. 1328, 85th Cong., 1st sess., at pp. 71–72 (1957) (emphasis added).

[110] CAB Answer to subcommittee questionnaire, question 13, reprinted in the appendix to the hearings.

[111] *Permanent Certification for Local Service Air Carriers: Hearings on S. 651 Before the Aviation Subcomm. of the Senate Comm. on Interstate and Foreign Commerce*, 84th Cong., 1st sess., at p. 206 (1955) (emphasis added).

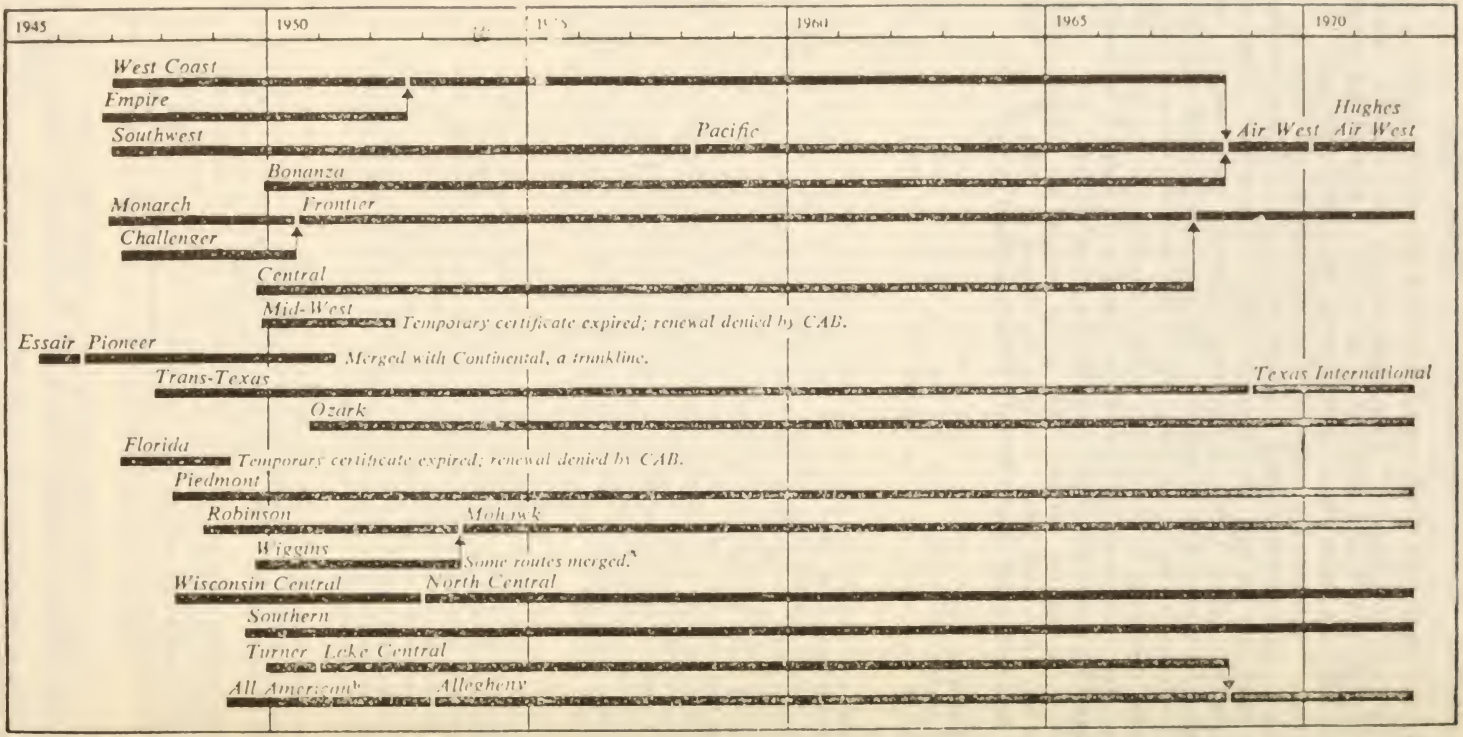
INITIAL TEMPORARY CERTIFICATES (LATE 1940'S)

On May 22, 1943, the CAB responded with the *Local, Feeder, and Pick Up Service Investigation.*[112] The basic aim of the resulting "local service" experiment which resulted was to see if specialized small airplanes—different from those used by the grandfathers—and "no frills" service, "emphasizing economy and less luxurious standards of service [than the grandfathers]" could be profitably undertaken between small towns and the nearby large cities which received trunkline service. The CAB examiners, however, were pessimistic and foresaw the need for large subsidy. Because this service was seen as different from trunkline service, the CAB decided to certificate new carriers to engage in the "local service experiment." The understanding at the time seems to have been that these feeder lines would not be allowed to compete directly with the grandfathers.

Nineteen local service carriers were given temporary 3-year certificates between 1945 and 1951: 1 began operating in 1945, 9 in 1947, 7 in 1949, and 2 in 1950. Their history is summarized in table B5.

[112] 6 CAB 1 (1943).

TABLE B5.—HISTORY OF "LOCAL SERVICE CARRIERS" OR "FEEDERS"
[1945–72]



Source: Eads, "The Local Service Airline Experiment," p. 4 (1972).[113]

[113] Mr. Eads' sources were in turn: Civil Aeronautics Board, "Annual Airline Statistics," various years; "Handbook of Airline Statistics, Calendar Years, 1949–1956" (1960); "Handbook of Airline Statistics, 1969 Edition" (1970), pp. 503–6; CAB, "Aircraft Operating Cost and Performance Report for Calendar Years 1969 and 1970" (August 1971), vol. 5, pp. 99–100; and relevant preceding issues.

a. The certificate of E. W. Wiggins Airways was not renewed, and some of its routes were taken over by Mohawk.

b. All American Aviation operated a certificated mail pick-up service for several years before initiating passenger service on March 7, 1949.

Rather than certifying a few routes to test the commercial viability of this service, the Board broadened the experiment to include 30,000 route miles and 547 points of 1950.[114]

The CAB began by severely restricting the type of service that the feeder carriers could offer. The carriers were required to stop at all intermediate points on every flight. These restrictions were designed to ensure that the feeders were conducting the intended experiment rather than competition with the grandfathers. Where grandfathers were given feeder-like routes, they were not so restricted.[115]

From the beginning the local service carriers demonstrated an inclination to concentrate their attentions on the larger markets that provided commercially viable levels of traffic. They sought a loosening of the restrictions requiring them to serve all the small towns on their routes[116] and purchased aircraft better suited to the larger routes than the smaller ones.

In 1947 the CAB made an important decision in failing to penalize Pioneer Air Lines for purchasing DC–3's that were obviously too large for feeder service. The DC–3 shortly became the standard aircraft for all the local carriers. This inclination to concentrate on larger markets generally characterized the local service carrier throughout the period 1945 to 1974 and is of central importance in understanding their development. Caves' explanation of this phenomenon was as follows:

> In a many-faceted industry such as air transport, the subsidy provisions affect many incentives facing carrier managements other than those for cost minimization. Imagine a firm selling services in many markets. Its selling prices are fixed by public authority and it receives public subsidy. Some of the markets are competitive and yield profits. Others, in which it is the sole seller, yield either trivial profits or commercial losses. The subsidy is fixed rather than being set retroactively, but the fixed rate is changed frequently toward yielding normal profits in future periods. *What would such a firm do that an unsubsidized firm, finding itself in the same situation, would not do?* The most obvious prediction is that the subsidized firm would have no reason for giving up its unprofitable markets. Indeed, if it maximizes total profits (and not the internal rate of return), it would seek to offer as much unprofitable service as it could. Each new money-losing market would mean more equipment and a larger investment base on which to earn a normal rate of return. Of course, the same could be said for increasing its share of the profitable competitive markets. Efforts to gain a larger share of these markets, if successful, would yield temporary profits until over-all subsidy was adjusted downward. On the other hand, reduced profits due to the increased costs of a brisk competitive struggle in a potentially profitable market would yield temporary losses until subsidy is adjusted upward. What the balance of these two possibilities is one cannot say, and *the final answer seems to be that the profit incentive for expansion into unprofitable monopoly markets is not clearly greater or less than that for expansion on the same scale into competitive markets.* The psychic income of a quiet life cuts one way, the psychic income of besting one's rivals, the other. *But this indeterminacy disappears if we change the assumptions slightly and consider a subsidized firm which believes that the growth of markets and cost-*

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[114] Id. at p. 85.

[115] Consider, for example, the following quotation from the Great Lakes Area Case, 8 CAB pp. 360, 392 (1947): "In authorizing services of a purely local or feeder character, it has been our policy in the past to include in the certificates certain restrictions with respect to skip-stop and nonstop operations. This was done to avoid uneconomical duplication of existing trunk-line services. In the instant case, however, no such restrictions are being imposed and this will enable the carriers authorized to conduct these operations to experiment with a wide variety of nonstop and shuttle services without impairing the quality of their long-haul service. Since the operations will be conducted by trunk-line carriers along the course of their established routes, the element of duplication of services and consequent diversion of revenues from other carriers will not exist. At the end of the temporary period of 3 years we shall be able to assess the value of this type of service in meeting the travel needs of the public, and shall be able to compare it with local feeder service systems which we have authorized in various sections of the country."

[116] George C. Eads, *The Local Service Airline Experiment*, pp. 85–86 (1972).

cutting innovations will remove it from subsidy in the near future. Then it will have an enormous incentive to pursue larger shares of more lucrative markets while still receiving subsidy, for such an action could have an enormous payoff in the future at no present cost. (The Civil Aeronautics Board maintained the position through the 1940s that subsidy to the trunk carriers was only a transitional form of aid.) [117]

RENEWAL OF TEMPORARY CERTIFICATES

The initial certificates for the local carriers came up for renewal in 1949 and 1950. The experiment was clearly a failure if judged by short-term economic standards. The subsidy required far exceeded original estimates and was quite high per additional passenger to whom air service was offered by virtue of the program. Table B6 indicates that the Federal Government was paying roughly $25 to $75 per passenger for each "small town" passenger in 1949:

TABLE B6.—MAIL REVENUE PER ORIGINATING AND DEPARTING PASSENGER AT EXCLUSIVELY SERVED STATIONS, MARCH 1949, AND MAIL REVENUE AS A PERCENTAGE OF NONMAIL REVENUE, 1949

Airline [1]	Exclusively served stations	Mail revenue	Arriving and departing passengers, exclusive stations [2]	Passengers arriving and departing at exclusively served cities as a percentage of total passengers	Mail revenue per passenger, exclusive stations	Rank	Ratio of mail revenue to nonmail revenue	Rank
Challenger Airlines	7	$88,809	1,305	64.4	$68.05	6	2.08	4
Empire Air Lines	8	56,297	1,636	59.7	34.41	8	1.97	5
Monarch Air Lines	9	104,857	1,330	73.5	78.84	4	2.43	3
Piedmont Aviation	3	100,727	391	7.9	257.61	1	1.04	9
Pioneer Air Lines	8	157,352	1,385	15.9	113.61	2	1.06	8
Robinson Airlines	1	36,738	1,470	49.0	24.99	10	.98	10
Southwest Airways	15	111,360	4,282	53.8	26.01	9	1.09	7
Trans-Texas Airways	10	128,125	1,764	57.5	72.63	5	3.06	2
West Coast Airlines	10	119,829	3,305	73.8	36.26	7	1.35	6
Wisconsin Central Airlines	10	81,692	932	58.9	87.65	3	3.80	1

[1] Includes only airlines operating throughout 1949. Allegheny Airlines initiated passenger operations in March 1949; Bonanza Air Lines in December; Central Airlines in September; Lake Central Airlines in November; Mid-West Airlines in October; Southern Airways in June; and E. W. Wiggins Airways in September. Florida Airways ceased operations in March 1949.

[2] Adjusted to exclude passengers traveling between exclusively served points.

Source: George C. Eads, The Local Service Airline Experiment, p. 101 (1972).[118]

In 1951 a member of the CAB observed "Operations of the local service carriers, when viewed as an 'experiment,' have been of value only in proving that at the present state of the art short-haul service is a field generally ill-adapted to air transportation." [119]

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[117] Richard E. Caves, *Air Transport and Its Regulations*, pp. 264–65 (1962) (emphasis added).

[118] Mail payments were, in practice, subsidy payments unrelated to the cost of transporting the mail. This situation persisted until mail and subsidy payments were separated only after extensive Congressional inquiry. See *Airline Industry Investigation: Hearings before the Senate Committee on Interstate and Foreign Commerce*, 81st Cong., 1st and 2d sess. (1949–50) (34 days of hearings, 2,545 pages).

Nevertheless, all but two local service certificates were reissued. There were two major reasons. First, CAB's economic analysis was often poor. Undeserving lines were often recertificated easily while CAB challenged lines who could show that they were at least reasonably promising.[120] Second, Congress and local community political pressure effectively prevented the CAB from suspending service once begun. For example, although the Government was paying $72.63 per passenger for Trans-Texas Airways' additional service (now, Texas International), CAB's proposal to end the certificated prompted protest from 44 senators and congressmen.[121]

"ROUTE STRENGTHENING" AND TRANSFER OF SMALL-TOWN ROUTES FROM GRANDFATHERS TO LOCAL-SERVICE CARRIERS

The CAB has generally consistently taken actions which, in its judgment, would minimize direct federal subsidy to the airlines without jeopardizing the existence of an airline.[122] In the late 1940's and early 1950's most of the grandfather airlines were taken off of subsidy. This was made possible largely by suspending the grandfather's authority in unprofitable markets and certifying a local service carrier to serve instead. Between 1949 and 1964, a trunk carrier was either replaced by a local service carrier or suspended to relieve the local service carrier of competition in at least 137 markets.[123] Even more dramatically, during this period the number of cities and towns served by the grandfathers as a group dropped from 367 to 234 while the stations served by the locals increased from 318 to 450.[124] These shifts were usually unopposed by the grandfathers.[125]

The CAB also took several steps aimed at reducing the local service carriers' need for subsidy. First, route restrictions were significantly loosened so that not every flight had to serve every point on the route. Second, the CAB allowed the locals to drop marginal points beginning in about 1951—although the formal "use it or lose it" policy was not adopted until 1961. On the other hand, the CAB did not contrive a subsidy scheme that avoided the problems of straight cost-plus financing until 1961. In that year the CAB introduced "class rates" which, in effect, calculated subsidy payments based upon the average costs of the local service carriers rather than a carrier's individual costs, so that each carrier was given an incentive to best the average and retain the difference.[126]

The net effect of these efforts, however, failed to check the increasing need for subsidy.[127]

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[119] Trans-Texas Certificate Renewal Case, 12 CAB pp. 608, 631 (1951).
[120] George C. Eads, *The Local Service Airline Experiment*, pp. 97–102 (1972).
[121] Trans-Texas Certificate Renewal Case, 12 CAB pp. 608, 609 (1951).
[122] Richard E. Caves, *Air Transport and its Regulators*, p. 263 (1962).
[123] George C. Eads, *The Local Service Airline Experiment*, p. 112 (1972).
[124] CAB, *Domestic Route System: A Staff Study by the Bureau of Operating Rights* at p. 19 (1974).
[125] George C. Eads, *The Local Service Airline Experiment*, p. 112 (1972).
[126] Id. at pp. 123–25.
[127] Id. at p. 142.

TABLE B7.—LOCAL SERVICE AIR CARRIER SUBSIDY, BREAK-EVEN NEED, AND RETURN ON INVESTMENT AND EQUITY, 1954–66

[Dollar amounts in thousands]

Year	Adjusted subsidy	Break-even need [1]	Break-even need less aircraft depreciation	Interest, taxes, and return element [2]	Rate of return on stockholder equity [3] (percent)	Rate of return on total investment [3 4] (percent)
1954	$23,807	$22,409	$20,497	$1,398	14.16	13.47
1955	22,051	20,540	18,785	1,511	7.54	7.48
1956	24,960	23,793	21,702	1,167	−4.44	−.32
1957	31,071	30,411	27,574	1,660	−11.43	−2.62
1958	32,938	31,089	27,709	1,849	10.73	9.24
1959	43,252	41,544	36,244	1,708	.52	4.95
1960	54,837	51,954	46,230	2,883	14.82	9.12
1961	61,920	53,578	46,452	8,342	21.23	11.05
1962	66,776	54,574	46,857	12,202	19.25	11.04
1963	67,043	55,923	47,079	11,120	13.05	8.88
1964	63,559	48,813	39,306	14,746	16.29	10.08
1965	62,618	41,921	30,214	20,697	19.30	12.08
1966	56,439	31,457	15,080	24,982	16.74	7.87

[1] Operating revenues (less subsidy paid) minus operating costs.
[2] Adjusted subsidy minus break-even need.
[3] Including investment tax credits.
[4] Before interest payments.

Sources: Civil Aeronautics Board, "Handbook of Airline Statistics," 1965 edition, p. 233; 1967 edition, pp. 225, 383, 385; 1969 edition, pp. 205, 371, 373.

Several reasons for this failure may be suggested. First, "route strengthening," to the extent that it placed local service carriers in competition with grandfathers, probably did not generate any significant excess profits which could have been used to "cross-subsidize" the weaker markets.[128] In fact, route-strengthening likely had the opposite effect. In order to serve larger routes, the local carriers purchased larger aircraft which became even more costly to use on the thin small-town routes. Second, Congressional and small communitys' pressure weakened the CAB's resolve to vigorously apply its "use it or lose it" policy. As late as 1967, 41 of 473 points served by the local service carriers generated less than 5 passengers a day.[129] Furthermore, the CAB permitted extension of local carrier service to an additional 56 generally unprofitable cities between 1951 and 1959.

Third, Congressional support of the local service carriers affected CAB policy on the crucial issue of aircraft purchase. In the early 1950's two large locals, Pioneer and Southwest, purchased larger, more expensive airplanes, and the Board refused to raise the subsidy accordingly, pointing out that the new planes were even less well suited for local service than the DC–3's.[130] Caves attributes this denial to an "economy drive." [131] Eads suggests pressure from the grandfather carriers who were worried about competition.[132] In 1954 and 1955 Congress held several hearings which resulted in permanent certification of the local-service carriers over CAB objection. In 1955 Mohawk and Allegheny Airlines, two important locals, purchased new, larger equipment and the CAB granted additional subsidy.[133]

[128] CAB (Bureau of Operating Rights), *Service to Small Communities*, pt. III, pp. 25–27 (1972), reprinted Hearings at pp. 673–74. See p. 673, supra.
[129] George C. Eads, *The Local Service Airline Experiment*, p. 116 (1972).
[130] Pioneer Air Lines, Inc., Mail Rates, 17 CAB 499 (1953) (dkt. 5499); 18 CAB 561 (1954) (dkt. 6375).
[131] Richard E. Caves, *Air Transport and its Regulators*, p. 261 (1962).
[132] George C. Eads, *The Local Service Airline Experiment*, p. 130 (1972).
[133] Id., pp. 132–34.

PERMANENT CERTIFICATION OF THE LOCAL SERVICE CARRIERS BY CONGRESS (1955)

In the early 1950's the local carriers began petitioning Congress for permanent certificates. Both the House and Senate held hearings in 1954 and in 1955. The only opposition to the proposal was expressed by the CAB (the grandfathers did not testify). Chairman Gurney of the CAB pointed out that legislation was unnecessary since the CAB already had the power to give permanent certificates and summarized his reasons for opposing permanent certificates at that time:

> Mr. GURNEY. Well, thank you very much. Well, the Board's reasons for their position may be summarized as follows: I am now turning to my prepared script here.
> 1. Permanent certification would lessen the incentive which these carriers now have to increase their revenues and hold down their costs;
> 2. It would make more difficult the improvement of the route systems of the several carriers;
> 3. It would saddle the Government with an annual subsidy bill of over $20 million for the indefinite future;
> 4. The proportion of subsidy to total revenues is still too high (an average of 47 percent) to warrant permanent certification of all carriers in the group.[134]

Congress rejected the CAB's reasoning and granted certification based upon such considerations as the difficulties of attracting capital and talent without permanent authority, the success that permanent certification seemed to produce in the grandfathers, and the litigation costs that would be saved.[135] The Senate Aviation Subcommittee report noted, "[T]he failure of the Board to grant the carriers permanent certificates for these routes is not understood." [136]

The local service carriers were further aided by legislation in the late 1950's. In 1957 Congress guaranteed loans to the locals for the purchase of new equipment.[137] In 1958 capital gains were made tax exempt if used to purchase new equipment.[138]

In the face of rising subsidies, President Kennedy called for a subsidy reduction program in 1961. The locals responded with a proposal which would have allowed more direct competition with the grandfathers. The CAB resisted this plan, however, and adopted a plan which would have gradually reduced the number of routes which the CAB would subsidize and require consolidation of small airports that were close together. Vigorous opposition by Congress and local communities to reduction in service, however, largely thwarted this plan.[139]

INCREASED COMPETITION BETWEEN LOCAL SERVICE AND GRANDFATHER CARRIERS AND THE DECLINE OF SMALL-TOWN SERVICE (1965–69)

In 1966 the Senate Aviation Subcommittee conducted a general review of the local carrier program. At the hearings, the CAB agreed to follow the locals' proposal for more direct competition against the

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[134] *Permanent Certificates for Local Service Air Carriers: Hearings on S. 651 before the Aviation Subcomm. of the Senate Comm. on Interstate and Foreign Commerce*, 84th Cong., 1st sess., at p. 114 (1955).
[135] Subcomm. on Aviation of the Senate Comm. on Interstate and Foreign Commerce, Permanent Certificates for Local Service Air Carriers, S. Rept. No. 124, 84th Cong., 1st sess., at pp. 3–4 (1955).
[136] Id
[137] George C. Eads, *The Local Service Airline Experiment*, p. 128 (1972).
[138] Id. 106.
[139] Id. 148–49.

grandfathers.[140] The result was another, more thoroughgoing "route-strengthening" program under which the locals were given authority to bypass small towns, were chosen over the grandfathers for some new routes, and were certified to compete aginst the grandfathers and each other in a number of markets.[141] Subsidy payments by the CAB during this period are listed in Table B8.

TABLE B8.—SUBSIDY PAYMENTS BY THE CAB TO THE LOCAL SERVICE CARRIERS, 1967–74

Year	Millions	Year	Millions
1967	$51.0	1971	$58.9
1968	36.0	1972	66.5
1969	34.8	1973	64.6
1970	40.3	1974	68.5

Source: CAB, Handbook of Airline Statistics, p. 221 (1973 ed.); CAB, "Quarterly Airline Industry Economic Report; December 1974," p. 11 (1975).

This program lasted from 1966 to 1969. In 1967 the CAB revised the subsidy formula and sharply reduced the subsidy payments between 1966 and 1970. The reduced subsidy and the conversion to large jets in the late 1960's gave the local-service carriers a large incentive to abandon small markets. The route-strengthening program not only failed to produce the anticipated "cross subsidy," it provided a CAB-approved plan for abandoning small towns. As a result, 78 of approximately 450 towns and cities served by the local service carriers lost their service between 1966 and 1972.

These service reductions were the subject of two careful hearings by the Senate Subcommittee on Aviation. In the second set of hearings, Chairman Browne of the CAB conceded that mistakes had been made and that the "local service carriers" were not equipped to serve small towns. The CAB proposed turning small town service over to the "air taxis" that had sprung up to meet the needs not served by the locals. Subsidy contracts were to be let by competitive bids.[143]

The route strengthening program led to significant increases in the level of competition between locals and trunks. Between 1965 and 1970, the fraction of revenue passenger miles of the local service carriers in competitive markets increased from 31 percent to 45 percent.[144] The average number of passengers per station increased from 72 to 167 (compared with 1,544 for the grandfathers), and the average stage length jumped from 106 miles to 160 miles (in 1971), compared with 591 for the grandfathers.[145] In short, the local service carriers became significantly more like the grandfather carriers despite the wide gap that remained.

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[140] See *Nonstop Authority for Local Service Carriers in Markets on Their Respective Lineal Route Segments, Notice of Proposed Rule Making*, — CAB — (1966).

[141] George C. Eads, *The Local Service Airline Experiment*, pp. 153–66 (1972).

[142] *Local Air Service to Small Communities: Hearings on S. 796 Before the Subcomm. on Aviation of the Senate Comm. on Commerce*, 92d Cong., 2d sess., pp. 11–17 (1972).

[144] CAB, *Domestic Route System: A Staff Study by the Bureau of Operating Rights*, p. 104 (1974).

[145] Id., at pp. 16–17.

TABLE B9.—LOCAL SERVICE AIR CARRIER SUSPENSIONS, CONSOLIDATIONS AND DELETIONS, DEC. 15, 1965 TO JUNE 1, 1970

Carrier and point suspended	Date suspended	Period of suspension [1]
Air West:		
1. Apple Valley, Calif	Apr. 5, 1966	Suspended until airport becomes adequate.
2. Burley-Rupert, Idaho	Dec. 29, 1969	Terminates Dec. 29, 1972.
3. Burns, Oreg	Mar. 7, 1967	Permanently deleted.
4. Coeur d'Alene, Idaho	do	Do.
5. Elko, Nev	July 1, 1965	Do.
6. Lakeview, Oreg	Mar. 7, 1967	Do.
7. Pendleton, Oreg	do	Do.
8. Port Angeles, Wash	Aug. 23, 1967	Do.
9. Salem, Oreg	Mar. 7, 1967	Do.
10. Sun Valley-Hailey-Ketchum, Idaho	Dec. 29, 1969	Terminates Dec. 29, 1972.
Allegheny:		
11. Columbus, Ind	Dec. 15, 1969	Permanently deleted.
12. Danville, Ill	Oct. 7, 1968	Terminates Oct. 20, 1978.
13. Du Bois, Pa	Mar. 10, 1969	Terminates Feb. 28, 1979.
14. Elkins, W. Va	Sept. 15, 1969	Terminates Oct. 2, 1979.
15. Findlay, Ohio	Dec. 15, 1965	Permanently deleted.
16. Hagerstown, Md	Nov. 15, 1967	Terminates Nov. 15, 1977.
17. Hazleton, Pa	July 22, 1968	Terminates July 1, 1978.
18. Jackson, Mich	Dec. 15, 1965	Permanently deleted.
19. Johnstown, Pa	Jan. 6, 1970	Terminates Jan. 6, 1980.
20. Kokomo-Logansport-Peru, Ind	Nov. 15, 1969	Terminates Nov. 4, 1974.
21. Lawrenceville, Ill.-Vincennes, Ind	Dec. 18, 1969	Terminates Dec. 15, 1972.
22. Mansfield, Ohio	July 1, 1969	Terminates June 16, 1979.
23. Marion, Ind	Nov. 15, 1969	Terminates Nov. 4, 1974.
24. Oil City-Franklin, Pa	Jan. 15, 1970	Terminates Feb. 28, 1979.
25. Richmond, Ind	Dec. 15, 1965	Permanently deleted.
26. Salisbury, Md	June 1, 1969	Terminates Nov. 14, 1977.
27. Wheeling, W. Va	June 1, 1970	Until 60 days after decision on Docket 21851.
28. Zanesville-Cambridge, Ohio	Jan. 15, 1970	Until 60 days after decision on Docket 21410.
Frontier:		
29. Dodge City, Kans	Oct. 27, 1968	Suspended until airport can accomodate CV–580's.
30. Glasgow, Mont	do	Until 90 days after decision on Docket 21401.
31. Glendive, Mont	do	Do.
32. Havre, Mont	do	Do.
33. Lewiston, Mont	do	Do.
34. McAlester, Okla	Oct. 27, 1968	Suspended until airport can accomodate CV–580's.
35. Miles City, Mont	Apr. 7, 1970	Until 90 days after decision on Docket 21401.
36. Sidney, Mont	July 1, 1968	Do.
37. Williston, N. Dak	Apr. 7, 1970	Do.
38. Wolf Point, Mont	do	Do.
Mohawk:		
39. Ogdensburg-Massena, N.Y	Feb. 6, 1970	Terminates Feb. 6, 1980.
40. Poughkeepsie, N.Y	Feb. 1, 1970	Terminates Feb. 1, 1973.
41. Rutland, Vt	Feb. 6, 1970	Terminates Feb. 6, 1980.
North Central:		
42. Cadillac-Reed City, Mich	Aug. 1, 1966	Permanently deleted.
43. Land O'Lakes, Wis	Sept. 15, 1968	Terminates Sept. 15, 1971.
44. Mankato, Minn	Feb. 8, 1969	Terminates Feb. 8, 1971.
45. Pontiac, Mich	Aug. 1, 1966	Permanently deleted.
46. Port Huron, Mich	June 11, 1965	Do.
47. Winona, Minn	Nov. 1, 1969	Terminates Oct. 26, 1972.
Ozark:		
48. Kirksville, Mo	Mar. 1, 1966	Permanently deleted.
49. Moberly, Mo	Apr. 27, 1969	Do.
Southern:		
50. Mississippi Test Facility, Miss	Apr. 30, 1967	Do.
51. Myrtle Beach, S.C	Apr. 21, 1969	Do.
52. Rockwood, Tenn	Feb. 4, 1966	Do.

Source: Local Air Service to Small Communities: Hearings Before the Subcommittee on Aviation of the Senate Committee on Commerce, 91st Cong., 2d sess., at pp. 159–60 (1970).

TABLE B10.—LOCAL SERVICE AIR CARRIER SUSPENSIONS, CONSOLIDATIONS AND DELETIONS, JUNE 1, 1970 TO MAR. 31, 1972

Community	Carrier	Date approved	Carrier providing replacement service (if any)
I. Suspensions of service:			
Cape May, N.J.	Allegheny	July 12, 1970	Atlantic City Airlines.
Prescott, Ariz.	Air West	Sept. 26, 1970	Apache Airlines.[1]
Kingman, Ariz.	do	do	Do.
Hutchinson, Kans.	Frontier	Oct. 1, 1970	Air Midwest.
Great Bend, Kans.	do	do	Do.
Martinsburg, W. Va.	Allegheny	Nov. 30, 1970	Henson Aviation.
Muncie-Anderson-New Castle, Ind.	do	Mar. 5, 1971	Vercoa Air Service
Altoona, Pa.	do	Sept. 15, 1971	Air East.
Trenton, N.J.	do	Jan. 7, 1972	Ransom Air lines.
II. Consolidation with another point:			
Borger, Tex.[2]	Frontier	June 10, 1970	
Vicksburg, Miss.[3]	Southern	Sept. 14, 1970	
Martinsburg, W. Va.[4]	Allegheny	Oct. 18, 1971	
Liberty-Monticello, N.Y.[5]	Mohawk	Oct. 26, 1970	
Battle Creek, Mich.[6]	North Central	Oct. 31, 1971	
Land O'Lakes, Wis.[7]	do	Jan. 18, 1972	
Tacoma, Wash.[8]	Air West	Pending	
III. Deletions of certificates authority:			
Sedalia, Miss.	Ozark	Aug. 3, 1970	
Long Beach, Calif.	Air West	Aug. 19, 1970	
Marysville Yuba City, Calif.	do	Dec. 27, 1970	
Portsmouth, Ohio.	Allegheny	Aug. 9, 1971	
Blacksburg-Radford-Pulaski, Va.	Piedmont	Feb. 28, 1972	
Marion, Ind.	Allegheny	Pending	
Baker, Oreg.	Air West	do	
Ontario, Oreg.	do	do	
Roseburg, Oreg.	do	do	
Southern Pines-Pinehurst-Aberdeen, N.C.	Piedmont	do	
Elizabeth City.	do	do	
Duncan, Okla.	Frontier	do	

[1] Air West resumed service Oct. 31, 1971.
[2] Borger is now served through Amarillo.
[3] Vicksburg is now served through Jackson.
[4] Martinsburg is now served through Hagerstown (by Henson Aviation).
[5] Temporary authority lapsed.
[6] Battle Creek is now served through Kalamazoo.
[7] Land O'Lakes is now served through Rhinelander.
[8] To be served through Seattle.

Source: Hearings on S. 796 before the Subcommittee on Aviation of the Senate Committee on Commerce, 92d Cong. 2d sess., p. 18 (1972).

Between 1969 and 1974, the CAB declined to hear all but a handful of applications for further competitive authority between the carriers. The boundary between the grandfathers and the locals was thus effectively frozen for this period. The reasons and legality of this policy are explored more fully in the main body of the report.[148]

Of the 13 local-service carriers certified by Congress in 1955, 8 were operating under their own names in 1974. The other 5 were acquired by the survivors; none went bankrupt. One additional local service carrier, Air New England, was certificated by the CAB in 1974.

In 1974 the local service carriers as a group flew 10.8 billion revenue passenger miles, about 8.4 percent of the domestic scheduled passenger business.[149] About 45 percent of the locals' business is in competition with the grandfathers.[150] Since most of the monopolistic markets served by the local service carriers are small feeder routes not desired by the grandfathers, the proper measure of business taken away from the grandfathers by virtue of the entry of the local service carriers is approximately 4½ percent.

[148] See 142–159, supra.
[149] CAB, *Quarterly Airline Industry Economic Report—December 1974*, at pp. 7, 15 (1975).
[150] Assumes the 1974 fraction is the same as the 1972 ratio. CAB, *Domestic Route System: A Staff Study by the Bureau of Operating Rights*, App. B, Chart 2 (1974).

SUPPLEMENTAL CARRIERS: THE "IRREGULAR OR NON-SKED FRINGE"

The grandfather air carriers operated a network of scheduled air transportation between the major cities of the country. The "feeder fringe" discussed above grew up to carry passengers between the terminals of the grandfathers' system and the outlying small towns. The fringe of "irregulars" or "non-sked" carriers consisted of companies who operated primarily nonscheduled or irregular service between the same cities served by the grandfathers on a scheduled basis. The irregular fringe carriers have developed into the supplemental carriers—carriers holding supplemental certificates—who, in 1974, provided primarily charter air service.

The growth and development of the irregular fringe up to 1956 was the subject of detailed investigation by the House Judiciary Committee (the Celler Committee). The Celler report, written in 1957, provides an excellent review of the early history of the irregulars. An abridged version of the historical section of that report follows (footnotes are omitted).

[EARLY BEGINNINGS]

When the Civil Aeronautics Act was passed in 1938 there were two general types of common carrier air transportation enterprises. Regularly scheduled service over prescribed routes was provided by some 16 grandfather carriers. In addition, there were a number of carriers that operated from a fixed base to furnish a call and demand air service, flying on request without regard to a schedule. For the most part their aircraft were of a small, nontransport type and their transportation services were incidental to other activities such as the sale and service of aircraft, flight instruction, and the operation of airports. Although these carriers provided air transport of limited economic significance in the industry, their very existence demonstrated the presence of a market unsatisfied by the larger scheduled air carriers.

In the "grandfather" clause, the act assured operating certificates to the large airlines. No express provision was made in the act, however, for the fixed-base operators who engaged in air transportation as common carriers and so were subject to the act's economic regulatory provisions. Therefore, their operations would have been illegal had the Board not granted them operating certificates or exercised its power to exempt them from the act's economic regulations. The latter was accomplished on October 18, 1938, in Regulation 400–1: [the exemption authority is sec. 416 of the act].

That regulation authorized continuation of the fixed-base services by exempting persons engaged solely in nonscheduled transportation of persons or property by air from the requirement of obtaining a certificate of convenience and necessity and from most of the other provisions of title IV of the act. Under the regulation air transportation was considered to be scheduled if (1) it involved the flight of 1 or more airplanes from a takeoff point in 1 State, Territory, or possession of the United States to a landing point in another State, Territory, or possession or in a foreign nation; and (2) the carrier held out to the public that it would operate between such points with

a reasonable degree of regularity; and, (3) the carrier caused it to be generally understood that on its flights for hire it would accept for transportation members of the public or property as offered.

[CAB RESTRICTION 1944–51]

In 1944, the CAB instituted an investigation to determine whether any changes should be made in its economic regulations with respect to nonscheduled air services. The report of the hearing examiners recommended repeal of section 292.1 of the Board's economic regulations and the adoption of a new exemption. The examiners would have permitted casual, occasional, or infrequent trips between points other than the principal place of business of the exempted carrier, and, as to such services, trips in excess of 10 per month would have been deemed excessive. The examiners recommendation would have significantly broadened operations under the 1938 regulation by exempting even scheduled operations where reasonably direct certificated services were not available. Unfortunately, the examiner's recommendations were not adopted at that time. Not until 1955 did the Board recognize that the 10-flight limitation for carriers supplementary to the certificated service was in the public interest.

In its opinion, issued May 17, 1946, the Board noted that character of services performed under the nonscheduled exemption authority had changed from the type formerly provided by the fixed-base operators and were comparable to the services offered by certificated air carriers. The Board observed, however, that since the great majority of these new services had been inaugurated after the war, it had no direct information with respect to their extent, scope, or character. Nonetheless, the Board took notice of advertisements that had appeared in the public press and observed "These air transportation services are not the casual, incidental air transport operation of the fixed-base operator of prewar years * * * it is our opinion that by and large they are not services which were contemplated by the nonscheduled exemption order."

Although on completion of their investigation in 1946 only minor amendments were made in the nonsked regulation, to remedy the trend it had noted, the Board in its opinion emphasized in abundant detail the limited and sporadic nature of the services it considered legal under the exemption order. The Board stated:

> To fall outside the meaning of "regularly," a service must be so characterized by variation as to be free from the suggestion of a normal, customary, and common course of conduct, recurring operations which assume the nature of a pattern of course are regular, even though the practice of staggering such operations has been adopted.

The Board pointed out that "nonscheduled" had a far more restrictive meaning than the mere absence of a published timetable. In this connection it stated:

> The irregularity contemplated for exemption is that which neither directly nor indirectly leads the public to believe that between given points a reasonably certain number of flights per day or per week, or flights at approximately certain times

> or on certain days, may be anticipated with a reasonable degree of assurance. The irregularity exempted can be reflected only by rare and infrequent flights if between the same two points, and must be of such rarity and infrequency as would preclude any implication of a uniform pattern or normal consistency of operation.

It is quite clear that under the Board's opinion the test for irregularity depended primarily upon the state of mind of the traveling public and the air carrier. In an example outlining a charter operation which, through a course of conduct, with or without advertising, developed a weekend business to a vacation resort, the Board stated:

> When the point is reached at which operator and passenger *tacitly assume* that trips will be operated between such points with *fair* regularity, and that the only question is whether space can be obtained on such flights, the operation ceases to be a nonscheduled operation within the meaning of the ex-exemption order.

Despite these detailed instructions promulgated by the Board on May 17, 1946, that required exempted carriers to undertake only limited irregular operations, many of the "nonskeds" operated with increasing regularity to develop a service on a regular and frequent basis between fixed points. Since many of the noncertificated carriers obtained their revenues solely from the carriage of persons or property, the fixed-base operations heretofore characteristic of exempted carriers no longer were relied upon to support their transport operation. In short, the nonsked operators came into direct competition for traffic with the certificated carriers. In their competition the Board found that some nonscheduled operators acted in an irresponsible manner:

> Some of these noncertificated operations have become extensive, and have been conducted with little regard to the responsibility and duty owed to the public by a common carrier. Discriminatory rates, misrepresentations, and failure to furnish services contracted for, and the use of inadequate and makeshift equipment and facilities, are some of the more flagrant practices which have become all too frequent.

The Board's reaction to this condition was to take successive steps to restrict the operations of the irregular carriers in order to prevent their competing in services performed by the certificated carriers. Instead of assessing whatever benefits may have been brought to the industry by the changing nature of air transport services performed under its exemption regulation, the Board's response repeatedly was to redefine the exemption in the context of permissible irregular operations.

On May 5, 1947, the Board completely revised section 292.1, its nonscheduled exemption regulation. The revised regulation redesignated the carriers operating thereunder as "irregular air carriers" and required them to apply for and obtain letters of registration, 142 of which were issued.

Two classes of irregular air carriers, "large" and "small," were created. Companies that did not use any single aircraft unit having a gross takeoff weight in excess of 10,000 pounds or 3 or more units

with an aggregate gross takeoff weight of 25,000 pounds, were termed small irregular carriers. The small irregular carriers constituted over 80 percent of the total number of noncertificated carriers but flew only 10 percent of the total revenue passenger-miles flown by all such carriers. Under the May 5, 1947, amendment they were subjected to a much lesser degree of economic regulation than the large irregular carriers which were required to comply with most of the economic provisions of the act.

With respect to the requirement for letters of registration, the regulation provided that they be (1) nontransferable, (2) subject to immediate suspension when in the public interest in the opinion of the Board, and (3) subject to revocation for knowing and willful violations of the act, or the orders, rules, and regulations thereunder. The regulation retained the existing limitations on frequency of operation and spelled out in a more detailed and precise form how such limitations were to be accomplished.

On August 6, 1948, the Board issued a regulation, effective immediately, that closed the class of irregular carriers using large aircraft by providing that no further letters of registration would be issued to large irregular air carriers. As of August 5, 1948, there had been issued 147 letters of registration, of which 109 were then in effect.

On April 13, 1949, by an amendment effective May 30, 1949, the Board revised section 292.1 of its economic regulations so as to terminate the general class exemption of the large irregular carriers as of June 20, 1949, and to require individual exemptions for such carriers to operate. Applicants for an individual exemption covering all or part of the air transportation authorized to be performed as of June 19, 1949, were permitted to continue to operate under the general regulation during the pendency of their application. Only 97 applicants requested individual exemptions, although 105 letters of registration were in force on May 20, 1949.

In the April 13, 1949, revision of its economic regulations, the Board recognized that route-type operations by the large irregular carriers were economically necessary and caused violations of the existing regulations. It stated:

> To obtain sufficient utilization of large aircraft for an economical operation based on air transportation alone, a substantial number of flights between definite points becomes necessary or desirable, even if only 1 or 2 large aircraft are being used. The need for route operations is further emphasized by operational factors, such as considerations of maintenance, overhaul, fueling, and crew change for large aircraft.

Nonetheless, the Board adhered to its requirements that made only irregular and sporadic operations legal under the exemption and warned:

> One of the factors which the Board would take into consideration in disposing of such applications (for individual exemptions) is the extent to which the applicant had engaged in regular operations and had otherwise failed to comply with the requirements of the act and the Board's regulations.

In addition, the April 13, 1949, revision made large irregular carriers subject to all provisions of title IV of the act previously exempted except the requirement of section 401 (a), of a certificate of public convenience and necessity; section 404 (a), to the extent that it requires an air carrier to render adequate service; and the requirement of section 405 (e), for filing of schedules with the Postmaster General insofar as those sections would otherwise prevent them from undertaking irregular interstate and overseas air transportation of persons and property and foreign air transportation of property.

On November 4, 1949, the Board further amended the exemption regulation. This amendment made transportation of unticketed passengers by large irregular carriers a violation of section 401 (a) of the act. It required that all agreements pertaining to solicitation of passenger traffic be reduced to writing, and prohibited any large irregular carrier from entering any arrangement or understanding with other carriers to conduct combined operations which would provide a regular service although the service performed by any single member was irregular. Compliance with this regulation was expressly stated as a condition for the continued holding of a letter of registration.

On May 25, 1950, the policies and attitude of the Board with respect to applications for individual exemptions was enunciated in a unanimous opinion in *Large Irregular Carriers, Exemptions*, which ruled on some of the applications required by its April 13, 1949, order. In that decision the Board finally disposed of 11 of the 96 applications pending before it, by granting 2, denying 8, and dismissing 1. In its opinion the Board stated it had concluded "to deny the applications of all large irregular carriers which had been conducting route services."

The Board found that many irregular carriers, operating under color of the exemption regulation, had conducted consistently operations which far exceeded those authorized. Many carriers operated in a pattern that concentrated on relatively frequent and regular flights between a limited number of city pairs. These "route operations," the Board said, "have not been insubstantial."

Regular flights were furnished by many individual carriers. In addition, in order that they could hold out to the public an integrated service offering regular daily flights without any individual carrier's violating the Board's exemption regulation, some of the large irregular carriers combined their activities and operated as a group. The principal method used to accomplish such a combination was employment of a joint ticket or travel agent to sell tickets between designated points. While the flights of any one carrier of the group were irregular and infrequent, the group as a whole furnished a regular service to accommodate passengers on any day they wished to travel.

The Board found that the large irregular carriers who had concentrated on route-type services were the ones most frequently cited for unfair and prohibited practices. In this connection the Board said:

> Motivated by the desire of operating only with high load factors, many of these carriers have departed from their tariffs, misrepresented their services, canceled flights for which tickets had been sold, and resorted to other similar devices to increase their net return. In some cases they have

> even disregarded safety requirements by overloading their planes, by failing to maintain their equipment and to have it inspected at the required intervals, and by overworking their flight crews.

The Board found that the route operations conducted by the large irregular carriers not only were not in the public interest but in fact were adverse to the public interest. Several reasons were given in support of this finding:

> In the first place, such operation must, to a certain degree, be competitive with, and divert traffic from, the certificated carriers operating over the same routes. Although some new traffic has undoubtedly been developed by the irregular carriers which have operated a service at fares lower than those charged by the certificated carriers, *it seems equally clear that substantial diversion from the certificated carriers had occurred.*

Another reason advanced was:

> A further effect of the conduct of route operations is that violation of the Civil Aeronautics Act is encouraged. Because of the constant yielding to temptation by a number of large irregular carriers, a substantial enforcement problem has existed during the life of the present regulation. A very large portion of the time of the enforcement staff of the Board has had to be devoted to this branch of enforcement work. Not only has this resulted in a postponement of other pressing enforcement problems, but the frequency and extent of violations in this field has undoubtedly encouraged violations in other fields and a general aura of disrespect for the provisions of the Civil Aeronautics Act.

In its opinion the Board granted exemptions to the large irregular carriers which in the past had not been performing route services. The Board found that there was need for charter and special services in addition to such services provided by the certificated carriers.

Although these carriers received individual exemptions because they had conducted truly irregular operations in the past, the Board nonetheless ordered further restrictions imposed on them. The Board stated it would permit only 3 flights in the same direction during any period of 4 successive calendar weeks between 13 specified pairs of points. In addition to Miami-Puerto Rico and Los Angeles-San Francisco, 11 of the pairs of points involved were large cities connected with New York or Chicago. In addition, only 8 flights in the same direction in any period of 4 successive calendar weeks were allowed between any other pair of cites.

* * * * * * *

Concurrently with their applications for an individual exemption, some of the larger irregular carriers applied to the Board for certificate of public convenience and necessity that would authorize coach-type air service on east-west transcontinental routes within the United States. Originally, there were 18 applications from 15 different carriers but when the Board rendered its opinion on November 7, 1951, only 4 carriers' applications remained for consideration. The

others had been dismissed by the Board either at the request of the carrier or for failure to prosecute. The carriers involved were Air America, Inc., California Eastern Airways, Inc., Great Lakes Airlines, Inc., and Trans-American Airways, Inc.

The Board denied the applications for certificates of public convenience and necessity to engage in specialized low-fare passenger service principally because approval of the applications would subject the certificated industry to competition. The Board stated:

> In this we are influenced in large part by the fact that from 3 to 4 airlines are already certificated and operating between each of the points which the applicants propose to serve, and that the certification of additional air carriers offering unlimited air-coach service would result in unnecessary, excessive, and destructive competition.

Although the Board recognized that the extension of low-fare, coach transportation would bring into existence an additional market composed of people who had not previously traveled by air, and who would not otherwise have done so, the Board did not feel such growth would justify specialized certificates. It concluded that introduction of new carriers operating an unlimited air-coach service "would constitute a serious threat to the future orderly progression toward cheaper air transportation for the Nation as a whole."

This conclusion flowed from a belief that the existence of a market untapped by existing carriers represented potential revenues which would become available for further extension of the benefits of low-fare service to lean routes and to poorer traffic cities as the certificated carriers penetrated the new market. Competition from the applicants would dilute the as yet untapped revenues in the largest markets and thereby frustrate the bringing of coach services to the lean markets.

The Board declared that the future development and extension of low-fare air transportation was a major objective. Although it recognized that the certificated carriers had failed to experiment in and to develop coach business, the Board indicated it intended to accomplish its objective by exercise of its regulatory powers. In this respect the Board said:

> The duty rests upon the Board and the airlines alike to promote air transportation by all appropriate means within their power. The measures directed to that end, however, must be consistent with, and not inimical to, the development of an economically sound national system of air transportation. *We shall expect, and require, certificated carriers to expand and develop air-coach services, subject to appropriate Board regulation and, where necessary to accomplish that end, we will exercise our statutory power to compel the required reductions.*

Carried to its logical conclusion, this reliance of the Board on its ability through exercise of its regulatory process to require the certificated industry to develop new services, would justify the Board in refusing to authorize any new carrier to inaugurate a new service between points where any service at all was being offered by an existing carrier.

* * * * * * *

[CONGRESSIONAL RESPONSE: SENATE SMALL BUSINESS COMMITTEE INVESTIGATIONS: 1951–54]

On July 10, 1951, the Senate Small Business Committee issued a report on its investigation of the Board's treatment of the irregular carriers. The committee in its report took vigorous exception to the Board's actions on the applications for individual exemptions and to the "3 and 8" limitation on permissible large irregular flights. The report contended that the Board's exemption regulations had never prohibited a limited route-type service. It said:

> The concept of route-type service apparently did not even come into existence until May 25, 1950, when the Board first undertook to deny operating authority renewals on the ground that its regulations did not permit such operation.

To correct this situation, the committee recommended that the Board should:

> Issue a regulation which would establish a procedure for existing and new irregular carriers to file for permanent authority to operate an unsubsidized second-class or coach-type route service *without regard to regularity but limited as to the total allowable flights.*

The committee also concluded that the Board had never appreciated the benefits to air transportation inherent in the low-cost, air-coach type of service and that the Board had made no effort to devise procedures that would result in realization of these benefits. Instead the committee contended the Board had since 1948 continually harassed the irregular carriers with ever narrowing interpretation of the exemption regulations. It stated:

> To the extent that the "nonskeds" still exist today, they have managed to survive since 1948 in spite of constant harassment: The CAB's ever-narrowing interpretation of its regulations; new regulations designed to limit the "nonskeds" almost entirely to noncommon carrier operations; vigorous enforcement activities and regulatory actions which will, if unchecked, inevitably eliminate them within a year or two; and a campaign possibly inspired by major airlines to discredit them in the public mind.

Heated argument, manifested during our hearings, as to the value to the industry and to the public of the services provided by irregular carriers has accompanied the development of noncertificated operations after the war. The noncertificated carriers claim they contributed a number of "firsts" to air transportation, including the initiation and development of low-fare coach-type service, special coach configuration for high density seating, rearward facing seats, drop-down doors and carry-on luggage facilities. The certificated industry denied all of these claims and charged that the nonskeds injured the air transportation industry by "skimming the cream" from the profitable routes already developed by the established carriers, and injured the public by deceptive practices, and illegal operations.

Congressional committees in examining this problem have concluded that coach services were first offered by the nonskeds. The Senate Small Business Committee in 1951 said:

> It required several years of experimentation and public education on the part of the nonscheduled lines before the certificated airlines operated their first coach flight in November of 1948.

In 1953, the Senate Small Business Committee again found:

> The irregular airlines were the first to offer low-cost coach-type air service. The aircoach service by these irregular airlines stimulated the entry of the certificated carriers into the coach field and thus aided the development of a low-cost mass air transportation system.

The committee's report indicates that the CAB in its reactions to the "nonsked" problem, and in its failure to appreciate the benefits the irregular carriers conferred to air transport, was overly responsive to the interests of the certificated industry. In this connection the committee stated:

> There appear reasonable grounds for concluding that there exists a certain identity of interest between the CAB and the more firmly established portion of the industry. Such identity of interest is not infrequent between Government regulatory bodies and those subject to their regulation.

* * * * *

[CAB REACTION: THE LARGE IRREGULAR AIR CARRIERS SERVICE INVESTIGATION, 1951–1959]

In response to the Senate Small Business Committee's investigation and its highly critical July 10, 1951 report, on September 21, 1951, the Board instituted a general investigation to determine its future policy with regard to the large irregular carriers and the irregular transport carriers. In its general investigation, the Board consolidated all pending applications that had been filed for individual exemptions by the large irregular carriers, and terminated further processing of such applications. As of September 21, 1951, of the original 97 applicants, 17 had been granted temporary individual exemptions and were called irregular transport carriers, 46 applications still required action, and the remainder had been dismissed or denied.

In order to consider in one proceeding all policy matters relating to irregular operations that were supplemental and additional to the certificated service, the Board reopened and consolidated the individual applications of the 17 irregular transport carriers, reinstated and consolidated an application that had been dismissed, and consolidated 157 applications from 55 carriers for certificates of public convenience and necessity and exemptions to the extent that they requested authority to provide limited or controlled service supplemental to that of the certificated industry. The proceeding was of great

complexity, with hearings extending over 20 months, involving a total of 60 applicants, 25 intervenors, and 208 applications.

By January 20, 1954, evidence concerning both the public-interest issues and the individual-fitness issues had been heard with respect to but half of the 60 applicants. To expedite the proceeding, the Board concluded the evidence thus far presented would give it a representative cross section of industry as to the fitness, willingness, and ability of the applicants, and limited the evidence to be taken to matters relating only to the requirements of public interest and public convenience and necessity. In an opinion dated November 15, 1955, the Board decided the public-interest issues involved in the operations of the large irregular carriers.

In its opinion in the *Large Irregular Air Carrier Investigation* the Board found the supplemental carriers provided an impressive number of important benefits to the public. These benefits were of three classes. First, irregular carriers provided useful and necessary services the certificated industry was unable or did not care to provide in the fields of charter operations, special services, and individually ticketed travel. Second, the value of supplemental carriers for service to the Military Establishment was considered so important that commercial activities, in addition to military business, was authorized to assure continued existence of their fleet. Third, in addition to helping meet the public's immediate travel requirements, the irregular carriers were found to play "a significant role as innovators in air transportation."

From the standpoint of the traveling public's interest, the most outstanding contribution made by the irregular carriers was its pioneering of low fare air travel. In this regard the Board stated:

> It was they who made an invaluable contribution to air transportation by risking their own capital to pioneer in and develop the field of low-cost coach-type air transportation. And it was largely as a result of such successful experimentation that the certificated trunkline carriers became active participants in this field. This has made air transportation available to travelers who could not afford first-class accommodations. Today, air-coach travel is a vital and growing segment of the industry.

The importance of air-coach service is most dramatically shown in the field of air fares. At the hearings representatives of the Civil Aeronautics Board pointed out "the average rate paid by the coach passenger is some 30 or 35 percent below the rate paid by the first-class passenger."

Low fares of the air-coach service have generated new traffic for the entire industry by attracting a new class of people who otherwise could not afford to travel by air. Despite the claims of the certificated industry, most of the observers who have studied this problem have reached the conclusion that this new traffic, from previously untapped markets, has more than offset any diversion from the trunkline carriers.

Similarly, the Board itself in the large irregular air carrier investigation found:

> The record demonstrates that the operations of the irregular air carriers have not adversely affected the certificated car-

riers. Despite the fact that the operations of the irregulars have been increasing, the growth of the operations of the trunkline carriers has continued unabated. Between 1946 and 1954, the operations of the domestic trunkline carriers increased from 5,962,142,000 revenue passenger-miles to 16,331,348,000 revenue passenger-miles. Even more significant is the fact that the condition of the trunkline carriers has improved to the extent that, with minor exceptions, they no longer require subsidy support from the Government.

It is apparent that the coach service provided by the irregular carriers has not diverted traffic from the trunklines but, on the contrary, the new traffic generated by the low-fare service has been of direct and substantial benefit to the trunklines. The "skimming the cream" complaint of the certificated industry against the operations of irregular carriers does not have substance.

In its decision, the Board adopted a new policy toward large irregular carriers. It found that the irregular carriers provided necessary services to the industry that the certificated carriers had not supplied, and that the operation of the irregular carriers had not adversely affected the certificated industry. It found that the public interest required (1) the establishment of a new class of carriers known as supplemental carriers, and (2) their survival and continued healthy growth in a proper relationship to the certificated system.

The Board found the supplemental carriers were needed to provide the following types of services which it authorized to be provided under its exemption regulations:

(a) Unlimited charter operations on a planeload basis for the carriage of passengers and property in domestic, overseas, and Territorial (except intra-Alaska) operations, and of property only in international operations.

(b) Charter operations for the carriage of passengers in international operations on an individual exemption basis similar to that which is set forth in the 1955 Transatlantic Charter Policy, E–9221, adopted May 20, 1955.

(c) Individually ticketed or individually waybilled operations not to exceed 10 flights in the same direction between any single pair of points in any calendar month, except as to intra-Alaskan operations and except as to the carriage of passengers in international operations."

Thus, for the first time the Board lifted its prohibition against the regular operations noncertificated carriers needed for their survival if they were to use large aircraft economically as common carriers. This action came 10 years after the Board first recognized that its exemption regulations made no provision for the type of noncertificated air transportation that had developed in the postwar period. In permitting the supplemental carriers to provide a route-type service without regard to regularly but limited as to total volume of service rendered, the Board finally put into effect recommendations advanced by its hearing examiners in 1946, by the Senate Small Business Committee in July 1951, and by Commissioner Adams in his dissent in the Transcontinental Coach-Type Service case in November 1951.

The new policy of the Board also provides a way for supplemental carriers to become regularly certificated. If the volume of traffic of

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the supplemental air carriers over a segment or a group of segments exceeds for a period of 1 year, 15 percent of the traffic of the regularly certificated carriers on those segments, the Board will institute a formal proceeding to consider expanding the number of regular certifications thereon. Such proceedings are to be given priority of handling.

Most of the applicants in the large irregular air carrier investigation requested that their operating authority be in the form of a certificate. The certificated intervenors vigorously denied that the Board had authority to issue certificates for supplemental regular operations. The Board issued a temporary exemption to operate within the scope of the new policy, and deferred its decision as to whether the operating authority ultimately to be granted would be by certificate or by exemption until after consideration of the fitness qualifications of the individual applicants.

In its opinion, the Board emphasized its responsibility to assure continuation of the certificated system of airplane carriage required by the Civil Aeronautics Act. The Board considered its 10-flight limitation on the total number of permissible flights sufficient to prevent any substantial threat to the certificated industry, and that the protection against route-type competition was no longer necessary in the light of the tremendous postwar growth of air transport. In this connection the Board noted:

> The existing restriction against regular operations by these carriers served in part as a means of protecting the trunkline carriers from undue competition. It was adopted when the trunkline carriers were on subsidy. Under present conditions the original restriction has outlived its usefulness.

[COURT REVIEW OF CAB'S 1955 INTERIM ORDER IN THE "LARGE IRREGULAR CARRIER INVESTIGATION"]

Because it authorized limited route-type operations, the Board's order was challenged by the certificated industry. On July 19, 1956, the case was remanded by the court of appeals because the Board had not made appropriate findings to support its conclusion that a requirement of certification would be an undue burden on the carriers. In its opinion, the court rejected the certificated industry's contention that regular services consisting of 10 flights per month between any pair of points could not be authorized under the Board's exemption power. The certificated carriers had contended that the exemption granted for such limited regular services would destroy the certificated system of airplane carriage and therefor was illegal under the act. The court accepted the judgment of the Board that an air service supplemental to the certificated service is in the public interest and the Board's finding that the proposed supplemental service would not result in adverse economic effects upon the certificated system. The court concluded that if the Board makes the required finding as to undue burden "its present plan for a supplemental air carriage, effecting no excessive impact upon the certificated system, would be within the statutory exemption power (i.e., sec. 416 (b)).

* * * * * * *

[CELLER REPORT'S CONCLUSIONS]

Since World War II, the primary competitive problem in commercial aviation has centered around the attempts of new carriers to enter the industry. These new carriers, popularly called the nonskeds, and

now officially designated by the Board as "supplementary carriers,"[150a] have a record of performance that demonstrates they are valuable additions to the Nation's air-transport system. The force of their competition has improved the services of the industry and has brought about valuable benefits to the public. It is clear that they inaugurated and developed low-fare aircoach service to reach previously untapped markets before the certificated industry became interested in that type of traffic. Their continued healthy growth should be nourished by the Board as a means to assure constant competitive pressures, with resulting public benefits, from outside the certificated system.

Despite the value of the services provided by the noncertificated carriers, the Board from 1946 until 1955 refused to recognize merit in their new type of operation. By successive limitations on their operating authority the Board tried to restrict the noncertificated carriers to an outmoded role in the industry. The Board is properly subjected to severe criticism for the way it has dealt with the nonskeds and their problems.

The time required for the Board to find even a limited solution to the problem of new entrants into long-haul passenger markets on a regular basis can only be considered excessive. In 1946, the Board recognized that its exemption regulation was not adequate to encompass the flight patterns then in use by the new noncertificated operators. In 1948, the Chief of its Economic Bureau pointed out that some routine in operations was essential for carriers using large aircraft and recommended then that appropriate action be taken to bring that type of operation within either the Board's certification or exemption procedures. Not until the end of 1955, however, was the Board able to provide a mechanism for the new type of carriers to perform limited regular route-type operations legally in order to supplement the service of the certificated industry. It took nearly a decade for the Board to recognize that the realities of the air-transport industry no longer would fit prewar regulatory concepts. Such procrastination cannot but have had a deleterious effect upon the development of air transportation. It also worked unnecessary hardships on the newcomers who in good faith attempted to secure business and at the same time to comply with the Board's admittedly inadequate exemption regulation.

At the hearings the Board was charged with participation in a "callous, calculated conspiracy" with the certificated grandfather carriers to eliminate the entire nonscheduled industry. The committee rejects without qualification the contention that the Board's actions with respect to the nonscheduled carriers resulted from a conspiracy of any type between the Board and the certificated industry.[151]

* * * * * * *

The subcommittee believes the 416 (b) exemption should be used by the Board to the maximum practicable extent. Automatic pressures on the certificated industry generated from new competition originated through the exemption provisions would be a valuable tool to assist the Board in bringing about needed changes in the development of this young and growing industry. The automatic pressures from competition also would be of material assistance to the Board to assure that fares are maintained at the lowest reasonable levels in the public inter-

[150a] Technically, the term "supplemental carrier" as used in 1976 is derived from the 1962 statute granting the irregular carriers permanent operating authority.

[151] House Committee on the Judiciary, *The Airline Industry: Report Pursuant to H. Res. 107*, H.R. Rep. No. 1328, 85th Cong., 1st sess., 268–69 (1957).

est. Use of the exemption provision and the development of competitive pressures thereunder would diminish the regulatory task of the Board to accomplish the same goals by administrative fiat. It should be viewed as a valuable adjunct to assist the Board in its regulatory functions.

Liberal use of the exemption provision would assure continuous entry into air transportation as long as it is economically justified and would encourage the growth of the smaller carriers within the certificated industry. Such liberal exemption procedures with resultant increased competition should not pose any substantial threat to the established carriers.[152]

[END OF EXCERPTS FROM CELLER REPORT]

CONCLUSION OF THE LARGE IRREGULAR CARRIERS SERVICE INVESTIGATION (1959) AND COURT INVALIDATION (1960)

The *Large Irregular Carriers Service Investigation* was finally decided by the CAB on January 28, 1959. Of 54 applicants for supplemental authority, 23 were granted temporary certificates: 11 for 2 years and 12 for 5 years. The limited certificate was a new creation of the CAB. It gave the holder authority to fly unlimited charter flights and up to 10 scheduled flights per month, in each direction, between two points.[153]

On April 7, 1960, the U.S. Court of Appeals for the D.C. Circuit invalidated the temporary limited certificates issued to the irregulars in a suit by all the grandfather carriers.[154] The court's decision was based upon three alternative grounds: (i) the certificates failed to specify end points for which authority was granted, [155] (ii) the CAB failed to assess individually the applicants' fitness to perform the service authorized, [156] and (iii) the certificates illegally limited the number of scheduled flights to be performed.[157]

PERMANENT CERTIFICATION OF THE SUPPLEMENTAL CARRIERS BY CONGRESS (1962)

Congress swiftly amended the statute to permit such limited certificates, first by temporary legislation in 1960 and then by permanent amendment in 1962.[158] The main points of the 1962 amendment were:

(i) The supplementals received permanent certificates (rather than the temporary certificates issued by the CAB in 1959).

(ii) The supplemental certificate entitled its holder to offer *charter* service between unspecified points and to obtain "special operating authorization" for service between specified points for not more than 90 days where the CAB found there would be no "significant diversion" from a certificated carrier. Both types of service were subject to such conditions as the CAB might impose.

(iii) The exemption clause, sec. 416, was restricted by implication.

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[152] Id. 96
[153] Large Irregular Carriers Service Investigation, 28 CAB 224 (1959).
[154] *United Air Lines, Inc. v. CAB*, 278 F.2d 446 (D.C. Cir. 1960) (Prettyman, J.).
[155] Id. 448, based upon Act, sec. 401(e)(1) 49 U.S.C. 1371(e)(1), (1970).
[156] Id. at p. 447, based upon Act, sec. 401(d)(1), 49 U.S.C. 1371(d)(1) (1970).
[157] Id. p. 448 based upon Act, sec. 401(e)(4), 49 U.S.C. sec. 1371(e)(4) (1970).
[158] Pub. L. 86-661 (July 14, 1960) ; Pub. L. 87-528 (July 10, 1962).

The "special operating authority" replaced the 10 flight per month rule of the 1959 limited certificates which had been incorporated in the Senate version of the bill. This clause was clearly intented to protect the trunkline carriers from any "significant diversion." The Senate conferees agreed to this elimination with the greatest reluctance.[159] Both Senate and House committees believed that this act gave the CAB authority to permit service that could not be permitted under the exemption clause. This interpretation of the exemption clause appears to be at variance with the legislative history, the judgments of several previous Congressional committees, and the courts.[160] The exemption clause was not specifically amended. However, by explicitly limiting the "special operating authority," Congress seems to have impliedly restricted the authority that CAB could otherwise have granted under the exemption clause, sec. 416 of the act.

The 1962 amendment was backed by the CAB, and given more reserved support by the grand fathers and the supplementals.

The 1962 amendment resulted in immediate interim supplemental certification by the CAB for 15 carriers pending the outcome of the *Supplemental Air Service Proceeding.*[161] When this case was finally decided in 1966–67, the net result was the granting of permanent certificates to 13 carriers:

Table B11—Carriers given permanent supplemental certificates (1966–1967)

American Flyers Airline (merged with Universal in 1971)
Capitol Int'l Airways
Johnson Flying Service
McCulloch Int'l Airlines
Modern Air Transport
Overseas Nat'l Airways
Purdue Airlines (ceased operations in 1971)
Saturn Airways
Southern Air Transport
Standard Airways (bankrupt, 1969)
Trans Int'l Airlines
Universal Airlines (bankrupt, 1972)
World Airways

Source: CAB Orders E–23350 (Mar. 11, 1966) and E–25535 (Aug. 16, 1967).[162]

CAB AND CONGRESSIONAL ENCOURAGEMENT OF THE SUPPLEMENTAL CARRIERS (1962–70)

Between 1962 and 1970 the CAB encouraged the supplementals even to the detriment of the grandfathers. On September 18, 1964, the CAB reduced the grandfathers' permissible off-route charter operations from 10 percent to 2 percent of scheduled operations.[163] The grandfathers vigorously objected to this restriction although only two carriers were required to reduce actual charter operations. On March 11, 1966, the CAB first permitted three stop inclusive tour

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[159] Supplemental Air Transportation: Hearings on S. 3566 Before the Subcommittee on Aviation of the Senate Committee on Commerce, 90th Cong., 2d sess., at p. 92 (1968).

[160] In addition to the preceding history, see *American Airlines, Inc.* v. *CAB*, 235 F.2d 845 (D.C. Cir. 1956), *cert. den. sub nom. Aircoach Transport Ass'n, Inc.* v. *American Airlines*, 353 U.S. 905 (1956).

[161] *Supplemental Air Service Proceeding*, Examiner's Decision at p. 11, note 23 (Aug. 27, 1965) (CAB docket 13795).

[162] Overseas National, Standard, and Vance received their certificates in Order E–25535; the others received their certificates in the earlier order.

[163] EDR–419, 29 Fed. Reg. 13246.

charters (ITC).[164] Traditionally, a "charter" was a contract for the exclusive use of an airplane for a specific trip which was purchased by a group as an entity or, at least, by individuals who were affiliated through a group. The ITC was a significant liberalization which allowed the supplementals to offer individually ticketed "tour charters" which included transportation to at least three different stops and ground accommodations. The ITC was adopted despite strong opposition by the grandfathers.

The grandfathers challenged the ITC in court as exceeding the "charter" authority granted by Congress in the 1962 amendment. The legislative history was unclear on this point and the courts split.[165] The Congress immediately amended the statute explicitly to permit ITC's. The CAB and supplementals strongly supported this amendment, and the grandfathers strenuously opposed.[166]

During this period before 1970, the supplementals' charter business expanded rapidly, particularly in the long distance North Atlantic and Hawaiian markets. The impact of the supplementals was to increase greatly the number of passengers and decrease the fares. (See tables B12, B13, and B14.) The grandfathers responded to this competitive pressure with dramatically lower fares. In the important Hawaiian market, the grandfathers successfully recaptured the initial gains made by the supplementals. In 1970, however, the CAB suspended these Hawaiian fares of the grandfathers as below cost.

TABLE B12.—SUPPLEMENTALS' GROWTH IN REVENUE PASSENGER MILES COMPARED TO CERTIFICATED ROUTE CARRIERS' GROWTH[1]—1963-69

[Revenue passenger miles in millions]

	Supplemental carriers		Route carriers		Supplemental as a percent of total
	RPM's	Percent change	RPM's	Percent change	
Total system operations:					
1963	1,530	—0	53,216	—0	2.9
1964	1,480	—3.2	61,798	16.7	2.3
1965	2,464	66.5	73,215	19.0	3.3
1966	4,095	66.2	88,142	21.0	4.4
1967	5,997	46.4	111,778	27.4	5.1
1968	8,886	48.2	130,038	16.1	6.4
1969	11,145	25.4	142,698	9.7	7.2
Domestic operations:					
1963	335	—0	39,016	—0	.9
1964	410	22.6	45,046	15.5	.9
1965	469	14.5	53,225	18.7	.9
1966	574	22.3	63,085	19.1	.9
1967	709	23.5	79,522	26.4	.9
1968	840	18.5	92,112	15.6	.9
1969	1,117	33.0	100,448	9.0	1.1
International operations:					
1963	1,195	—0	14,200	—0	7.8
1964	1,070	—10.5	16,752	19.9	6.0
1965	1,995	86.4	19,990	19.6	9.1
1966	3,521	76.5	25,057	25.9	12.3
1967	5,288	50.2	32,256	29.5	14.1
1968	8,046	52.2	37,926	17.3	17.5
1969	10,028	24.5	42,250	11.4	19.2

[1] Includes both commercial and military business.

Source: Air Fares and Charter Service: Hearings Before the Subcomm on Transportation and Aeronautics of the House Comm. on Interstate and Foreign Commerce, 91st Cong., 2d sess., p. 17 (1970).

[164] SPR-14, 31 Fed. Reg. 4779, codified 14 CFR 378.

[165] Compare *Pan American World Airways, Inc.* v. *CAB*, 380 F.2d 770 (2d Cir.), aff'd 391 U.S. 461 (1967) (4-4) (rejecting ITC) with *American Airlines, Inc.* v. *CAB*, 365 F.2d 939 (D.C. Cir. 1966) (approving ITC).

[166] *CAB Inclusive Tour Authority: Hearings on H.R. 17685 Before the Subcommittee on Transportation and Aeronautics of the House Committee on Interstate and Foreign Commerce*, 90th Cong., 2d sess. (1968).

TABLE B13.—SUPPLEMENTALS' GROWTH IN TRANSATLANTIC COMMERCIAL PASSENGER TRAFFIC COMPARED TO CERTIFICATED ROUTE CARRIERS' GROWTH, 1960–69

[Passengers in thousands]

	Supplemental carriers		Route carriers		Supplemental as a percent of total
	Passengers	Percent change	Passengers	Percent change	
Year:					
1963	35		922		3.7
1964	67	91.4	1,185	28.5	5.4
1965	107	59.7	1,416	19.5	7.0
1966	168	57.0	1,591	12.4	9.6
1967	279	66.0	1,955	22.9	12.5
1968	395	41.6	2,092	7.0	15.9
1969	794	101.0	2,482	18.6	24.2

Source: Air Fares and Charter Service: Hearings Before the Subcomm. on Transportation and Aeronautics of the House Comm. on Interstate and Foreign Commerce, 91st Cong., 2d sess., p. 408 (1970).

TABLE B14.—DOWNTREND OF TRANSATLANTIC JET FARES (1960–70)—NEW YORK–LONDON

	1st class		Economy		Economy peak season		Excursion (round trip)		14 to 21 days international travel
	1 way	Round trip	1 way	Round trip	1 way	Round trip	14 to 21 days	29 to 45 days	
1960	$500	$900.00	$270	$486.00					
1961	500	900.00	270	486.00					
1962	500	900.00	270	486.00					
1963	475	902.50	263	499.70					
1964	375	712.50	210	399.00	$255	$484.50	$300		
1965	375	712.50	210	399.00	255	484.50	300		
1966	375	712.50	210	399.00	255	484.50	300		
1967	375	712.50	210	399.00	255	484.50	300		
1968	375	712.50	210	399.00	255	484.50	300		
1969	375	750.00	210	420.00	255	510.00	300	$250	$270
1970	375	750.00	210	420.00	255	510.00	300	250	270

Source: Air Fares and Charter Service: Hearings Before the Subcomm. on Transportation and Aeronautics of the House Comm. on Interstate and Foreign Commerce, 91st Cong., 2d sess., p. 328 (1970).

CAB EFFORTS TO RESTRICT THE SUPPLEMENTALS' GROWTH AND CONGRESSIONAL RESPONSE (1950–74)

On May 8, 1970 the CAB proposed new charter rules which would have significantly restrained this competition between the supplementals and grandfathers. The House Subcommittee on Transportation and Aeronautics, chaired by Congressman Friedel, immediately conducted extended hearings into these matters. While the supplementals and grandfathers each pressed their positions with great fervor, the CAB took no position because the rulemaking proceeding was in progress.[168] Chairman Friedel strongly supported the cause of the supplementals.[169] The rule that eventually was adopted by the CAB was substantially less restrictive than the proposed version.[170]

The supplementals soon urged that charter rules be loosened even further to permit increased competition with the grandfathers, at least for segments of the pleasure traffic. The Senate Aviation Subcommittee held extensive hearings on the proposed "one-stop in-

[168] *Air Fares and Charter Service: Hearings Before Subcommittee on Transportation and Aeronautics of the House Committee on Interstate and Foreign Commerce*, 91st Cong., 2d sess. (1970).

[169] 117 Cong. Rec. 21894 (June 29, 1970). No committee report on these hearings was issued.

[170] ER–659, Amdt. 9, 36 Fed. Reg. 2486 (Jan. 29, 1971).

clusive tour charters" (OTC) in 1972, 1973, and 1975. The Congressional inclination in favor of competition and frustration with CAB's failure to implement these policies is well expressed by Senator Cannon, chairman of the Aviation Subcommittee, in his opening statement during the 1975 hearings.

> Today's hearings are on S. 421, my bill, entitled the "Low-Cost Air Transportation Act" which by law will broaden the opportunity for low-cost travel.
>
> I sincerely regret the necessity of either introducing S. 421 or of holding hearings on it because the policies enunciated in the bill, in my view, are timely, sensible, economically realistic, but most important, are within the authority of the Civil Aeronautics Board to adopt on its own initiative.
>
> For the past several years I have been dissatisfied with the way in which air transport policies have been adopted, followed and, in some cases, forced on the air carriers and the public by the CAB.
>
> Time and again the Board has ruled against efforts toward lowering air fares, against innovative discount proposals designed to get more people to fly, against lower cost economy fares for persons who desire fewer inflight amenities, and against carriers who wish to offer wider seats or against carriers who wish to provide lounges in their aircraft.
>
> At the same time the Board has followed a policy of unduly restricting the charter air transport business without regard to the fact that charter operations provide the only true low-cost air travel alternative to the great majority of Americans.
>
> Late last year the Board even went so far as to put out a notice of rulemaking indicating that it was going to abolish the affinity charter, the only type charter operation of any significance in the United States today.
>
> In short, the Board, in my opinion, has lost sight of its basic responsibility: That of promoting the public interest in air transportation.[171]

On August 7, 1975 the CAB, under a new chairman, John E. Robson, approved the OTC.[172]

While the OTC argument was proceeding, attempts were also made to limit competition over the North Atlantic by establishing a minimum charter fare high enough to protect the scheduled operations of the grandfathers from too much diversion and to protect the supplementals from each other. On May 9, 1973 the supplementals requested permission from the CAB to confer with all North Atlantic carriers for the purpose of agreeing on a minimum charter fare. Despite vigorous support for this idea by the CAB and certain members of the administration, no agreement was reached because of the objections of certain supplementals. On October 18, 1974, the CAB decreed an effective minimum charter rate by means of a "policy statement." [173] The apparent procedural irregularities and anticompetitive nature of this minimum charter floor prompted immediate hearings by this subcommittee on November 7 and 8, 1974.[174] After strong criticism of this procedure from Chairman Kennedy of this subcommittee and a stay of CAB's order pending the outcome of litigation issued by the U.S. Circuit Court of Appeals for the D.C. Circuit, CAB withdrew the "policy statement." [175]

CAB REGULATION OF THE "IRREGULAR" CARRIER FRINGE SUMMARIZED

A review of the history of the irregular fringe thus reveals a high mortality rate caused at least in part by federal regulation. In August 1948, when the CAB effectively closed entry into the irregular fringe, 147 letters of registration had been issued to irregular carriers and

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[171] *Low-Cost Air Transportation Act: Hearings on S. 421 Before the Subcommittee on Aviation of the Senate Committee on Commerce*, 94th Cong., 1st sess., at 1 (1975).

[172] SPR–85.

[173] PS–57.

[174] *Airline Charter Fares: Hearings Before the Subcommittee on Administrative Practice and Procedure of the Senate Committee on the Judiciary*, 93d Cong., 2d sess. (1974).

[175] PS–64 (Feb. 11, 1975).

109 were then in effect. In 1951, 60 irregulars applied for certificates in the Congressionally induced *Large Irregular Air Carrier Investigation*. When the investigation ended 8 years later in 1959, only 26 of the remaining 54 applicants were given certificates. In response to Congressional legislation in 1962, 15 interim supplemental certificates were issued to 22 applicants. The CAB's *Supplemental Air Service Proceeding* took another 3 years and concluded with permanent supplemental certificates for 13 carriers. Between 1965 and 1974, 3 supplementals went bankrupt or ceased operations and 1 merged with another supplemental. No additional supplemental has been certificated.[176]

As a group the supplementals carried 1.4 percent of the domestic revenue passenger miles.[177] It is impossible to measure what fraction of this traffic is captured from the grandfathers; clearly not all of it is, for some—perhaps many—of the passengers carried on the supplementals' charter flights are people who would not otherwise have flown on the regular scheduled flights.

III. OTHER ASPECTS OF CAB POLICY AND CONGRESSIONAL RESPONSE, 1938–74

Entry into the airline industry is, over the long run, the most important aspect of airline economic regulation and the one that has received by far the most Congressional scrutiny. Several other aspects of CAB regulation are also very significant, however. The historical development of these CAB policies are briefly summarized below.

COMPETITION AMONG THE GRANDFATHER CARRIERS

The grandfather carriers in 1938 all served monopoly markets, of course. Certification of one grandfather against another proceeded slowly until the mid-1950's. By 1953 only 29 of the leading 50 domestic markets were offering competitive service.[178] By December 1956, however, only 6 of the leading 50 markets were monopoly markets.[179] In 1972, 77 percent of the revenue passenger miles of the trunk carriers were competitive.[180]

There have been two periods which appear to account for most of the direct competition among the grandfathers although no good measures of aggregate market entry exist.[181] The first period was the mid-1950's during which Chairman Ross Rizley "strengthened" many of the route systems of the smaller trunks by giving them competitive authority against the Big Four.[182] The second period was the late 1960's during which the record prosperity in the airline industry prompted both more competition and extension of service to new points.[183] The overall guiding philosophy of the CAB in awarding

[176] Interstate Airmotive, Inc., a minor carrier certificated in 1969 but restricted to a 250-mile flying radius is not counted in this statement.
[177] CAB, *Air Carrier Traffic Statistics* 5, 93 (December 1974).
[178] House Committee on the Judiciary, *The Airline Industry: Report Pursuant to H. Res. 107*, H.R. Rep. No. 1328, 85th Cong., 1st sess.,112 (1957).
[179] Id.
[180] CAB, *Domestic Route System: A Staff Study by the Bureau of Operating Rights*, 104 (1974).
[181] G. Douglas and J. Miller, *Economic Regulation of Domestic Air Transport: Theory and Policy*, 115 (1974) ; CAB, *Domestic Route System: A Staff Study by the Bureau of Operating Rights* 105 (1974).
[182] House Committee on the Judiciary, *The Airline Industry: Report Pursuant to H. Res. 107*, H.R. Rep. No. 1328, 85th Cong., 1st sess., 112–13.
[183] G. Douglas and J. Miller, *Economic Regulation of Domestic Air Transport: Theory and Policy*, 115–16 (1974).

competitive route authority appears to be to protect the weak incumbent from competition and to strengthen the weak carrier by permitting him to expand into new markets competitively.[184] In October 1974 the staff of the CAB completed the first attempt by the Board to devise general standards for the award of new or competitive authority, *The Domestic Route System*. (This proposal is evaluated in the main body of this report.)

Caves suggests that the net effect of the CAB's entry decisions on the route systems of the grandfathers is probably small.[185] Douglas and Miller appear to disagree to some extent.[186]

FARE REGULATION

The regulation of fares involves three primary issues: the general level of fares, the degree of price competition, and the relationship among diverse "classes" and "discount" fares.

Until the early 1950's the CAB favored fares which maximized revenues in order that the Federal subsidy might be minimized.[187] In April 1952 the Board began its first general investigation into fare regulation.[188] A year later the investigation was aborted apparently due in part to industry desire to avoid an inquiry while profits were above normal.[189] Although the Celler committee found no proof of illegal pressure on the CAB, its report strongly criticized the CAB for failure to devise any standards for fare regulation.[190] The result of this criticism was the 5-year *General Passenger Fare Investigation* which announced a regulatory goal of 10.5 rate of return for the industry as a whole. Caves points out that the decision does not establish any standard for testing specific fares and concludes that it was grounded in largely invalid considerations.[191] The second CAB investigation into fares was hastened by a 1970 court decision which ruled that certain very specific fare suggestions from the CAB constituted rate-setting without the required full hearing.[192] The resulting 4-year *Domestic Passenger Fare Investigation* was completed in December 1974.[193] Beginning April 29, 1974, in accord with the *DPFI*, the CAB set all first class and coach air fares within the 48 state block by means of a "cost-based" formula. Previously, the CAB had rejected or failed to reject carrier initiated fare filings. The merits and mechanics of both methods are discussed in detail in the main body of this report.

The CAB has always opposed direct price competition. The only significant price competition that has existed is by means of discount fares limited to certain groups of people or restricted in some other manner, although such competition is not insignificant.

The discounts that proliferated in the late 1960's—youth fares, standby, nightcoach, excursion, family fares—were not used widely before 1966.[194] A discussion of CAB's banning of these fares in the *DPFI* will therefore be left to the main section of this report. Similarly,

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[184] Richard E. Caves, *Air Transport and its Regulators* 204–20 (1962).
[185] Richard E. Caves, *Air Transport and its Regulators* 230–31 (1962).
[186] G. Douglas and J. Miller, *Economic Regulation of Domestic Air Transport: Theory and Policy* 115–16 (1974).
[187] Richard E. Caves, *Air Transport and its Regulators* 141–45 (1962).
[188] E–6305 (Apr. 9, 1952).
[189] Richard E. Caves, *Air Transport and its Regulators* 146–48 (1962).
[190] House Committee on the Judiciary, *The Airline Industry: Report Pursuant to H. Res. 107*, H.R. Rep. No. 1328, 85th Cong., 1st sess.,157–58, 267–68.
[191] Richard E. Caves, *Air Transport and its Regulators* 152, 402 (1962).
[192] *Moss v. CAB*, 430 F.2d 891 (D.C. Cir. 1970).
[193] Order 74–12–110 (Dec. 27, 1974).
[194] Order 72–12–18 at 5 (Dec. 5, 1972) (the discount fare phase of the DPFI).

the relationship between first-class and coach fares first received attention in the *DPFI*.

INTERCARRIER AGREEMENTS

The most important agreements approved by the CAB are capacity reduction agreements, mutual aid agreements, the fixing of travel agents' commissions, and the activities of the Air Transport Association generally.

Capacity reduction agreements were unprecedented before 1970. Their development and consequences were the subject of this subcommittee's hearings on March 4, 1975 and are reported in the main body of the report.[195]

The mutual aid agreement under which airlines aid each other financially during certain kinds of strikes began on October 20, 1958, as a 1-year emergency pact. The CAB approved the agreement in 1959.[196] In year 1960 the CAB began a formal investigation of the mutual aid pact concept and, in 1964, approved the pact for 3 years.[197] In 1967 the airlines requested permanent approval of the agreement. The CAB began another formal investigation which resulted in CAB approval of the pact in 1970. The Board granted a petition for reconsideration and held a second formal investigation between 1970 and 1972, and granted final approval in February 1973.[198] In spring 1975 the Senate Aviation Subcommittee held hearings on various bills to outlaw the mutual aid pact.[199] In 1975, 16 of 19 major airlines are members of the mutual aid agreement.[200]

Travel agents' commissions have been established by inter-airline agreement since 1941.[201] The agreements are worked out by the Air Traffic Conference (ATC), a semi-independent arm of the Air Transport Association. ATC's activities do not appear to have been investigated by the CAB or Congress prior to the Celler hearings in 1956. As a result of severe criticism in the Celler report,[202] the CAB conducted an investigation which forced the ATC to relax restrictions on persons who could become travel agents but resulted in general approval of the scheme for setting agents' commissions.[203] A second investigation in 1970 likewise resulted in general CAB approval with modifications.[204]

MERGERS

Except for the early 1950's, the CAB has opposed mergers between airlines unless the acquired airline was very small or failing.

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[195] See pp. 142–59, supra.
[196] Order E–13899 (May 20, 1959).
[197] 40 C.A.B. 559 (1964).
[198] Order 70–7–114, reconsideration granted; order 70–11–110 (1970), final approval; order 73–2–11 (1973).
[199] The hearings and report of the Aviation Subcommittee were not available as of the writing of this report.
[200] Testimony of Congressman Karth, hearings, p. 2228. See also, Joseph F. Fulton, "The Airlines Mutual Aid Agreement: Background Information, and Pro and Con Arguments," Congressional Research Service, 74–149E (1974).
[201] House Committee on the Judiciary, *The Airline Industry: Report Pursuant to H. Res. 107*, H.R. Rep. No. 1328, 85th Cong., 1st sess.,194.
[202] Id. 209–16.
[203] Order 70–12–165 (Dec. 31, 1970).
[204] Order E–14647 (Nov. 12, 1959); Order E–14924 (Feb. 15, 1960).

Table B15.—SUCCESSFUL AND UNSUCCESSFUL MERGERS INVOLVING DOMESTIC TRUNK AIR CARRIERS, 1938-73

Year	Number of trunk carriers [1]	Comments
1938	16	
1939	16	
1940	16	United [2]-Western [2] merger denied.
1941	16	Transcontinental and Western Air [2] absorbed Marquette.
1942	16	
1943	16	
1944	16	
1945	16	Northeast [2] absorbed Mayflower; American [2] absorbed American Export.
1946	16	Braniff [2]-Frontier merger denied; American [2]-Mid-Continent [2] merger denied.
1947	16	Capital [2]-Northeast [2] merger denied.
1948	16	
1949	16	
1950	16	Mid-Continent [2]-Parks merger denied.
1951	16	Continental [2]-Midwest merger withdrawn.
1952	16	Northwest [2]-Capital [2] merger dismissed, Braniff [2] absorbed Mid-Continent [2]; Western [2] absorbed Inland [2].
1953	14	Delta [2] absorbed Chicago and Southern.[2]
1954	13	Eastern [2]-Colonial [2]-National [2] merger denied.
1955	13	Continental [2] absorbed Pioneer; Delta [2]-Northeast [2] merger withdrawn.
1956	13	Eastern [2] absorbed Colonial.[2]
1957	12	
1958	12	
1959	12	
1960	12	
1961	12	United [2] absorbed Capital.[2]
1962	11	Continental [2] -National [2] merger withdrawn.
1963	11	Pan American-TWA [2] merger withdrawn; American [2]-Eastern [2] merger disapproved.
1964	11	
1965	11	
1966	11	
1967	11	Eastern [2] absorbed Mackey; Braniff [2] absorbed Pan American-Grace; Western [2] absorbed Pacific Northern.
1968	11	
1969	11	
1970	11	American [2] absorbed Trans Caribbean; Northeast [2]-Northwest [2] merger approved, subsequently terminated by Northwest.[2]
1971	11	
1972	11	Delta [2] absorbed Northeast [2]; American [2]-Western [2] merger denied; Northwest [2]-National [2] merger dismissed; Eastern [2]-Caribair merger disapproved, but pending.
1973	10	Acquisition of Caribair by Eastern [2] approved.

[1] Any airline that operated for any portion of a year is counted for that year. Figures do not include Pan American (see table 7-2, note a).
[2] Indicates trunk carrier.

Source: G. Douglas and J. Miller, Economic Regulation of Domestic Air Transport: Theory and Policy, pp. 121-22 (1974).

OTHER FORMS OF FINANCIAL AID

The most important forms of indirect financial aid for the airlines within the discretion of the CAB have been the mail subsidy and depreciation allowances.

In the late 1940's, the CAB responded to financial difficulties brought about by a downturn in the national economy by permitting large mail payments, in some cases retroactively. Insistant calls in Congress for separation of the amount paid for mail transport from the amount paid in direct subsidy were resisted by the CAB. Very extensive hearings by the Senate Committee on Interstate and Foreign Commerce led to subsidy separation by CAB administrative order, but only after the departure of the CAB Chairman J. J. O'Connell. This administrative solution defused the situation sufficiently to prevent statutory attempts to reform the subsidy method by Senator John F. Kennedy in 1953.[266] With the ending of subsidies to the grandfather carriers, the subsidy issue has arisen primarily in the context of the desirable extent of local service.

[266] Richard E. Caves, *Air Transport and its Regulators*, p. 277 (1962).

EXTENT OF CONGRESSIONAL REVIEW GENERALLY

There is, unfortunately, no summary index of Congressional discontent or content with CAB policy. The following table, however, gives a rough indication of the extent of Congressional questioning of CAB's practices:

TABLE B16.—APPROXIMATE NUMBER OF BOARD APPEARANCES BEFORE CONGRESSIONAL COMMITTEES, [1950–75]

Year	Appearances	Year	Appearances
1975	11	1962	14
1974	16	1961	20
1973	6	1960	21
1972	9	1959	12
1971	15	1958	16
1970	11	1957	19
1969	15	1956	14
1968	6	1955	13
1967	4	1954	8
1966	11	1953	8
1965	9	1952	3
1964	7	1951	8
1963	11	1950	12

Prepared by Nancy Brewer of the Office of Congressional Liaison, CAB (1975).

IV. SUMMARY OF THIS HISTORICAL REVIEW

Early and prolonged dependence of the airline industry upon Government support necessarily gave rise to a degree of governmental oversight and regulation. This Federal involvement has favored some companies more than others from the earliest days of commercial aviation.

Prior to 1938, Congress several times attempted to correct this uneven governmental aid by means of temporary or partial remedies. Examples include the various competitive bidding and contract payment plans of the late 1920's, the Watres Act of 1930, the Black Investigation of 1934, and the Black-McKellar Act of 1934. These efforts, however, proved incapable of ensuring appropriate levels of governmental support of the airlines on a fair and equitable basis.

Finally, in 1938, Congress completed its only comprehensive review of Federal aviation policy in an attempt to formulate a permanent solution to the airline problem. The Civil Aeronautics Act of 1938 was a reasonable and natural step in light of the national experience with airlines and other modes of transportation prior to 1938. To correct the partisan manipulation of necessary Government support that had occurred in the past, an impartial independent agency was created. To avoid split authority and interdepartmental rivalry, a unified authority was established. To guard against the operation of economic incentives which might result in unsafe or unreliable service to the public, broad economic regulatory powers were vested in the CAB.

The legislative history of the 1938 Act reveals clearly that the intent of Congress was not to close entry and eliminate competition in the airline industry, but rather to promote entry and competition to the maximum degree consistent with the *public* welfare. It seems just as clear that the CAB has departed substantially from that original intent. As Senator Pat McCarren declared, "In the proposed bill there

is nothing to prevent 'a little fellow with a new idea, with plenty of capital,' from establishing an airline." Yet in 1974, despite a 250-fold growth, the "little fellows" have shared in only 5 or 6 percent of the business. "There is no competition being throttled in this industry," stated Senator Harry Truman. Yet in 1975, the CAB is asserting its authority to set *all* coach and first-class fares throughout the continental United States.

This is not to say that the CAB has opposed all aspects of entry and competition, for quite clearly it has not. More than three quarters of airline markets are today competitive. The CAB has generally opposed merger and price-fixing agreements. Domestic market allocation agreements have never been condoned, and capacity restraint agreements were not allowed before 1971.

Equally clearly the CAB has not hesitated to oppose the interests of the grandfather carriers from time to time. Despite vigorous opposition from the grandfather carriers, the CAB strengthened the local service carriers in the late 1960's, certificated the supplementals in 1959, and championed liberal charter rules in the late 1960's.

Nevertheless, certain plain facts remain, for whatever reasons. The regulatory scheme has prevented substantial entry into the airline industry despite tremendous growth. Only one airline has ever been certificated without sustained Congressional pressure. When the supplementals made substantial inroads against the grandfathers, the CAB turned against more liberal charter rules. When local-service carriers were beginning to make headway in obtaining competitive route authority against the grandfathers, they were met by a "route moratorium." When outsiders have applied for direct operating authority in competition with the grandfathers, they have been rejected or ignored by the CAB. The 36 years of regulation have seen little price competition, and few changes in the basic structure of the industry.

The contrast between the assurances of 1938 and the industry of 1974 is clear.

Federal economic regulation of the domestic passenger airlines has produced results which differ materially from the intent of Congress in 1938. The direction of this difference has been in protection of the status quo and opposition to fundamental competition by new entrants.

Never has Congress expressed any formal overall judgment about the CAB. No concurrent resolution or general statutory reform concerning economic regulation has been voted up or down by the Congress. A review of history reveals instead two primary kinds of Congressional expression: committee hearings and reports and Congressional changes to specific parts of the regulatory scheme.

The major committee actions have generally criticized the CAB for not permitting more competition through new entrance into the industry. The Senate Small Business Committee in the early 1950's, the Senate and House Commerce Committees in the mid 1950's and early 1970's (charter rules), and the House Judiciary Committee in 1957 (Celler report) are the primary examples. However, in fairness it must be emphasized that committee hearings by their nature are held when there is something to criticize rather than praise. Nevertheless, these committee inquires have usually been careful and responsible. Generally, they have not grown into full Congressional judgments because the CAB itself has taken the committees' work to

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express the will of Congress and has therefore responded with appropriate investigations and orders. The judgments of the committees thus cannot be disregarded entirely.

The partial judgments expressed by the full Congress include the George Resolution of 1942 (Senate only), the 1955 amendment (certificating local service carriers), the 1962 amendment (certificating supplemental carriers and restricting them to charter flight), and the 1968 amendment (expanding the definition of charters). The thrust of these actions appears to be an expression of support for competition and new entrance and, thus, disapproval of the overall approach of the CAB on this issue. The primary contrary evidence is the 1962 amendment which restricted the supplementals to charter flight. It does not appear that this was done to protect particular grandfather carriers, but rather to protect scheduled service per se. Indeed, the 1968 amendment approving the ITC somewhat retreats from the protection of scheduled service. When faced with a question of entrance and competition between kinds of air service, Congress has each time chosen to give permanent approval to the new entrant and to allow the public to choose between the services offered, at least within generally broad bounds.

Taken as a whole, congressional responses to CAB regulation appear to manifest a broad congressional policy substantially more sympathetic to competition and new entrance than the general policy otherwise pursued by the CAB. Viewed historically, this broad congressional policy seems to be a consistent continuation of congressional attempts prior to 1938 to correct governmental favoritism of certain companies—efforts which culminated in the creation of the Civil Aeronautics Board itself. *From this review of the history of congressional efforts to shape Federal aviation policy, it appears that Congress has not intended to ratify policies of the CAB which have opposed competition and entry; rather, Congress has more probably intended to adhere to the general principles of equal treatment for all, and protection of the public interest expressed in the Civil Aeronautics Act of 1938.*

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